The Economist

20010602

Fed up with gravy trains, salami tactics and upsetting the apple cart?

PRINT EDITION

Full contents | Subscribe
Enlarge current cover
Past issues/regional covers

NEWS ANALYSIS
POLITICS THIS WEEK
BUSINESS THIS WEEK

OPINION
Leaders
Letters to the editor
Blogs
Columns
Kallery

WORLD
United States
The Americas
Asia
Middle East & Africa
Europe
Britain
International
Country Briefings Go
Cities Guide Go

SPECIAL REPORTS

BUSINESS
Management
Business Education

FINANCE & ECONOMICS
Economics Focus
Economics A-Z

SCIENCE & TECHNOLOGY
Technology Quarterly

BOOKS & ARTS
Style Guide

PEOPLE
Obituary

MARKETS & DATA
Weekly Indicators
Currencies
Big Mac Index
Chart Gallery

DIVERSIONS
Correspondent's Diary

RESEARCH TOOLS

AUDIO

DELIVERY OPTIONS
E-mail Newsletters
Mobile Edition
RSS Feeds
Screensaver

CLASSIFIED ADS

The Economist Group
Economist Intelligence Unit
Economist Conferences
The World In
Intelligent Life
CFO
Roll Call
European Voice
EuroFinance Conferences
Economist Diaries and Business Gifts

EIU onlinestore

Advertisement

The new Economist screen saver is now available

Print Edition — June 2nd 2001

Whacked?
The president's loss of his Senate majority need not spell disaster ... More on this week's lead article

The world this week
Business this week
Politics this week

Leaders
The prospects for George Bush
Whacked?

Japan's economy
Money still matters

India's economy
Unlocking the potential

The EU's future
Dreams and discord

Aid and AIDS
Gambling with lives

Britain's election
Vote conservative

Letters
On inequality, the Caspian, global equity markets, Britain's Liberal democrats, France's election

Special Report
In an age without heroes

United States
The tax bill
Chicanery, but a boon to Bush

The "death tax"
Still breathing

Lexington
Tom Daschle to the rescue

Land-grant universities
An old dream in trouble

Atlanta
The city laid bare

Power politics
Westward ho!

The Americas
Colombia's internal conflicts
War comes to the cities

Peru's election
Known devil v unknown devil

Argentine politics
Menem's dates

Mexican politics
The dinosaurs suffocate

Brazilian politics
The mighty, fallen

Asia
Indonesia
Megawati makes her move

Kidnapping in the Philippines
No more ransoms

Crime and punishment in China
Bang, you're dead

Climbing Mount Everest
No room at the top

Income distribution in China
To each according to his abilities

Nuclear power in Japan
A pox on MOX

Europe
Russia's justice system
The path to reform—or another dead end?

Ukraine, Belarus and Moldova
A new misery curtain

Macedonia's ethnic fighting
On a knife-edge

Charlemagne
Baltasar Garzon

Ireland and the EU
Not quite so keen

Planning the Netherlands
Europe's next metropolis, maybe

Corruption in France
Dumas goes down

Britain
General election
What's wrong with William Hague

Campaign diary
On the trail

Newspapers and voting
The weakest link

An Italian in Liverpool
In search of an election

Riots
Shades of brown

Correction

Opinion polls
Differences of opinion

The vote in London
City state

Essex
Playing the hormone card

Bagehot
Michael Portillo's moment

Northern Ireland
Peace in danger

Articles flagged with this icon are printed only in the British edition of *The Economist*

International
Middle Eastern dynasties
Like father, like son

Zimbabwe
Bad month for Mugabe

Congo
Daring to hope, again

The Palestinian uprising
Arafat's studied non-interference

Previous print editions
May 26th 2001
May 19th 2001
May 12th 2001
May 5th 2001
Apr 28th 2001
More print editions and covers »

Subscribe
Subscribe to the pri
Or buy a Web subsc full access online
RSS feeds
Receive this page by

Advertisement

Blog: Free exchange
Real-life economics. No algebra
Read more :
Harry Potter and the Secret of Monetary P
The economics of wizarding
Fri, 20 Jul 2007 22:36:5
Patenting the wheel
There is such a thing as too much intellect
Fri, 20 Jul 2007 19:24:42
Economist.com
Global analysis. Daily

A survey of India's economy
The plot thickens
The rich get richer
Red tape and blue sparks
Grim reapers
The unknown majority
Islands of quality
Knights in tarnished armour
A management guide
Acknowledgements and sources
Offer to Readers

Business
E-Strategy brief: Siemens
Electronic glue

Alcatel and Lucent
The runaway bride

Gazprom
Miller rising

Football finances
Fifadom

Correction

Li & Fung
Link in the global chain

French railways
Très grand void

The Internet
Off with their beards

Face value
One Palm flapping

Pen computing
Mightier than the mouse?

Finance & Economics
Hedge funds
Swing, swing together

Inflation in America
The new old danger

The historical evidence
A trigger-happy Fed

Economics focus
Voting for welfare

Caribbean stock exchanges
Island-hopping

Banking in Brazil
Down to the roots

Japan's economy
Chronic sickness

Thailand's central-bank war
Governor's forced exit

Science & Technology
Patterns in financial markets
Predicting the unpredictable

Urban geography
Getting off the ground

Computer displays
Lightening up

Pest control
A dynamite idea

Books & Arts
Short stories
Brief encounters

Faith and politics in Iran
But what did he really mean?

High society in New York
That other gilded age

New fiction
What if

Modern drama
Summer of Sam

Correction

Jazz biography
Black fantasy

American press
Bring me a real paper

German press
Red and white all over

American and German bestsellers
What the world is reading

Corporate profiles
From forests to phones

Obituary
Malcolm McLean

Economic and Financial Indicators
Overview
Output, demand and jobs
Prices and wages
Performance versus potential
Stockmarkets
Commodity price index
Stockmarkets
Trade, exchange rates and budgets
Money and interest rates

Emerging-Market Indicators
Overview
Financial markets
Economy
Shiver me timbers

Advertisement

Advertisement

Advertisement

Classified ads

Jobs

Assistant Professor
The Faculty of Law of the University of Lucerne, Switzerland, announces the opening of t....

Business / Consumer

#1 rated internet business looking for professional consultants No previous technical experience required.

Tenders

#1 rated internet business looking for professional consultants No previous technical experience required.
Be....

Jobs

Publisher/Chief Operating Officer
Science and Development Network Description SciDev.Net is looking.....

Business / Consumer

#1 rated internet business looking for professional consultants No previous technical experience required.

Tenders

Supply of Laboratory equipment, Field equipment and Office and Library furniture for the Harry Oppenheimer Okavango Research Centre (HOORC).

Sponsors' feature

About sp

Copyright © The Economist Newspaper Limited 2007. All rights reserved. Advertising Info | Legal disclaimer | Accessibility | Privacy policy | Terms & Conditions | Help

Produced by = ECO PDF TEAM =
Thanks xxmama

Business this week

May 31st 2001
From The Economist print edition

Ailing

Japan's economic problems worsened. Industrial production fell by 1.7% in April compared with a month earlier. Over the past four months it has fallen by 20%, at an annual rate. Unemployment rose to 4.8%. And figures from Japan's bank regulator suggested that new bad loans appeared almost as fast as the banks were writing off their existing bad loans.

See article: Chronic sickness, and the debate over medicines

France's **Alcatel** and America's **Lucent** broke off at the 11th hour merger talks that would have led to the creation of the world's largest telecoms-equipment maker. What Lucent had hoped might be a merger of equals, Alcatel saw as a takeover of the loss-making American company. Lucent's management could not countenance an Alcatel-dominated leadership of their planned combined entity.

See article: The runaway bride

Mixed signals

America's GDP growth was revised downwards to 1.3% at an annual rate in the first quarter, from an estimated 2%. Durable-goods orders fell by 5% in April, a bigger drop than expected, as companies, fearful of the economic outlook, reined in investment (particularly IT spending). But America's consumers remain optimistic. Consumer confidence rose by more than expected in May.

See article: The new old danger

The European Union, Japan and seven other big traders have complained to the World Trade Organisation about an American law that passes **anti-dumping duties** to private companies. Robert Byrd, the Democratic senator who rammed the legislation through, will chair the Appropriations Committee when the Democrats take control of the Senate.

Tyco, a Bermuda-based conglomerate, agreed to buy **C.R. Bard**, an American medical-equipment maker, for $3.2 billion to strengthen its healthcare activities.

Who's got the energy?

Italy's stockmarket regulator is trying to establish who owns what bits of **Montedison**, an electricity company. **Electricité de France** had acquired a 20% stake. The Italian government swiftly issued a decree limiting its voting rights. Deutsche Bank admitted owning 3%, but would not say if it was working for EdF. An investor with a 10% stake was questioned by the regulator but denied any alliance with EdF. A 30% stake would force a bid for full control of the firm.

Rem Vyakhirev, long-serving anti-reformist boss of Russia's powerful, mainly state-owned monopoly gas company, **Gazprom**, was sacked. His fate had been considered a litmus test for Russia's president, Vladimir Putin, who imposed a supposedly more reformist chum as Gazprom's new boss.

See article: Miller rising

Chatu Mongol Sonakul was sacked as governor of **Thailand**'s central bank after refusing to raise interest rates. The government wanted higher rates to benefit savers.

See article: The governor's forced exit

Europe's business

QXL ricardo, a pan-European online auctioneer, announced cost-cutting measures that it claimed would put it on target to break even in 2003. It also announced a technology tie-up with Microsoft. QXL's shares soared by 65% in one day but then retreated slightly.

Temenos, a Swiss banking-software company, is preparing to announce an initial public offering that could value the business at as much as $1 billion. It may also establish whether European high-tech shares still have investor appeal.

Fraport, operators of Frankfurt airport, Europe's second-largest hub, said that its IPO would value the company at up to *euro*3.2 billion, well below recent estimates.

Kevin Hand resigned as chief executive of **Emap**, a British media group, after heavy pre-tax losses of £527m ($780m) in the year to the end of March. Mr Hand misread the £950m purchase of Petersen, an American magazine publisher that has performed poorly and will now be sold.

Trade unions complained that the introduction of **euro banknotes** might lead to job losses in the print industry. Wim Duisenberg, president of the European Central Bank, dismissed calls to release some notes early to ease the changeover, preferring a "big bang" on January 1st 2002.

AP

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Politics this week

May 31st 2001
From The Economist print edition

No surrender

The outlook was poor for President Abdurrahman Wahid of **Indonesia**, accused of incompetence and involvement in two corruption scandals, after the Indonesian parliament had voted overwhelmingly to proceed with impeachment. Police fired warning shots over the heads of Mr Wahid's supporters who had broken into parliament's grounds.

See article: Megawati makes her move

AP

Three Israelis and three Palestinians were killed as fighting continued to shake **Israel, the West Bank and Gaza**. Israel, maintaining its "ceasefire", desisted from large-scale military action. But the government approved plans for 700 new homes in West Bank settlements.

See article: Arafat's studied non-interference

Four followers of Osama bin Laden, a Saudi militant, were found guilty by a federal jury in New York of all charges arising from the 1998 **bombings of America's embassies** in Kenya and Tanzania in which 224 people were killed. Afghanistan's ruling Taliban called the convictions "unfair" and said they would not hand Mr bin Laden over to America.

Lionel Jospin, the prime minister of France, and Romano Prodi, the president of the European Commission, proffered their notions of the future of the **European Union**. Mr Prodi said that the EU should raise its budget by direct taxation. Mr Jospin suggested a "federation of nation-states" but not a German-style "federation", and argued for an "economic government"—translation, a political counterweight to the European Central Bank.

See article: Dreams and discord

AP

Colin Powell, America's secretary of state, failed to persuade fellow NATO members of the merits of George Bush's planned missile-defence shield at a meeting of foreign ministers in Budapest.

See article: In an age without heroes

In France, the **Elf affair** trial brought prison sentences for most of the accused, including Roland Dumas, former head of the Constitutional Council. End of the affair, perhaps not; end of France's corruption scandals, no way.

See article: Dumas goes down

EPA

More problems for **Brazil**'s president, Fernando Henrique Cardoso. An impending energy shortage has undermined his popularity and Antonio Carlos Magalhaes, until recently Mr Cardoso's most powerful political ally, resigned

from the Senate after breaking its rules.

See article: The mighty, fallen

The electors decide

Ireland's voters prepared for a referendum on June 7th on the EU's Nice treaty.

See article: Not quite so keen

In another defeat, **Mexico**'s once invincible Institutional Revolutionary Party lost an election for governor in Yucatan, one of its strongholds, to a candidate from President Vicente Fox's party.

See article: The dinosaurs suffocate

With the presidential election a week away, **Iran**'s President Muhammad Khatami used his main political rally to restate his vision of religious democracy, with justice for all. Young people, he said, particularly young women, were a priority. He is expected to win but, with Iranians disappointed at the pace of reform, the turnout may be low.

President Idriss Deby, who has ruled **Chad** since 1990, won re-election. Several people were shot as police arrested his six beaten rivals. They were later released.

Kashmir twist

Pakistan's military leader, Pervez Musharraf, formally accepted an invitation by the Indian prime minister, Atal Behari Vajpayee, to discuss the future of the disputed state of **Kashmir**.

Muslim hostage-takers struck again in the southern **Philippines**, kidnapping 17 Filipinos and three Americans at a holiday resort. As the army hunted for the kidnappers, the government said it would pay no ransom for the release of the captives.

See article: No more ransoms

Musical differences

AP

After heated debate, and against the urging of the conductor Daniel Barenboim, an arts festival in Jerusalem dropped plans to stage part of an opera by **Wagner**.

Henry Kissinger, America's former secretary of state, refused a summons to appear as a witness in a French investigation into the disappearance of its citizens at the time of General Augusto Pinochet's rule in Chile. He could not find the time while on a private trip to Paris.

President George Bush, making his first visit to **California** as president, rebuffed Governor Gray Davis's request for temporary price caps to ease the state's soaring electricity rates. Mr Davis said he would go to court to force the Federal Energy Regulatory Commission to impose caps.

See article: Westward ho!

Russia's president, Vladimir Putin, sent the Duma draft legislation designed to clean up the country's chaotic justice system. **Spain** announced plans to reform its own justice system.

See article: The path to reform—or another dead end?

In **Macedonia**, ethnic fighting carried on while NATO and the EU preached peace. But the ruling cross-community coalition, though badly strained, held together, just.

See article: On a knife edge

Leaders under fire

Soldiers rebelled against Ange-Félix Patasse, president of the **Central African Republic**, but failed to overthrow him. Libya sent troops to protect him.

Sudan's Islamist leader, **Hassan Turabi**, has been released from jail and placed under house arrest.

Colombia's vice-president, Gustavo Bell, became the country's new defence minister. His first challenge was a wave of bombs in the country's cities. The latest killed four people outside Bogota's National University.

See article: War comes to the cities

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

The prospects for George Bush

Whacked?

May 31st 2001
From The Economist print edition

The president's loss of his Senate majority need not spell disaster

YOU will be a one-term president, Senator Jim Jeffords told President George Bush when he bolted from the Republican Party, turning control of the Senate over to the Democrats. This parting rebuke is not a self-fulfilling prophecy. But it raises a disturbing possibility for Mr Bush: that the tax bill passed two days after Mr Jeffords jumped could be the high point of his presidency. If Mr Bush isn't careful, he risks being remembered for the tax cut (itself deeply flawed), a largely Democratic education bill, some rattled allies and three years of political torture at the hands of a Democratic Senate.

Mr Jeffords's action threatens Mr Bush in two ways. First, it raises the spectre of his father's struggles with Congress. George Bush senior saw his greatest achievement—victory in the Gulf war—frittered away largely because Democrats, under a soft-spoken Senate leader, used their majority power in the upper chamber to obstruct his policies and frustrate his legislative record. Now, another soft-spoken Democrat is taking over as leader of the Senate, and reinvigorated Democrats have the power to set the agenda. It is true that the same senators are there as before the defection and that Democrats cannot force their pet projects into law (as Newt Gingrich found, you cannot rule America from Congress). But, through their control of the Senate, Democrats can raise any chosen issue at the most difficult moment for the White House. This was the technique they used to such deadly effect in 1990-92.

Second, to make things worse for the president, Mr Jeffords's action denies the lesson Mr Bush had drawn from his father's experience: that to govern effectively you gather political capital where you can and spend it where you must. The passage of the tax cut should have provided Mr Bush with the capital he needed for the challenges to come. Mr Jeffords has snatched much of it away at the very moment it was earned.

Course adjustments

If Mr Bush is to avoid his father's fate, he will have to rethink both tactics and substance. This is not a matter of repudiating conservatism and becoming a vapid "centrist"—which he could not plausibly do, and should not in any case try to do. But the president does need to be shrewd. And he needs to take care that future victories, if any, are built on measures that will stand the test of time.

His first achievements have been less impressive in that respect than they might seem. His education reform is all right as far as it goes. But it balked at the issue of vouchers, will have no more than a marginal impact on public education (which is largely a state, not a federal, responsibility) and will not give Mr Bush sole bragging rights anyway because most of it was written by Democrats.

More important is the tax cut, the centrepiece of Mr Bush's term whatever else he does. As a matter of short-term politics, it was a triumph (even Mr Jeffords voted for it). But, as policy, it is a wrong-headed muddle. To cut taxes so sharply in the decade before the baby-boomers start to retire was always going to be risky. It will make reform of Social Security harder by reducing the budget surplus that could have been used to finance the costs of moving from one pensions system to another. Compounding this, the bill that has emerged from late-night negotiation may be one of the most gimmick-ridden ever to have

gone through Congress, which is saying something (see article).

The passage of the tax bill within days of the change in the Senate leadership shows how volatile American politics now is. In these circumstances, it is in Mr Bush's interests to get out and push an agenda, otherwise he will be swamped by uncertainty—which would be undesirable for the country, too. But there will be costs for both him and America.

Mr Bush had hoped to spend his capital from cutting taxes on partly privatising Social Security and reorganising America's armed forces (see article). These remain desirable aims. But they are controversial and require greater co-operation with Democrats than may now be possible. Mr Bush can prepare the ground for the reforms, and press them if he sees the chance. But he cannot rely on short-term political agreement.

Co-operate and outflank

If his term is not to consist of a modest education package, a bungled tax cut and three years of squabbling, Mr Bush will have to find other ways of co-operating with, or outflanking, Democrats in Congress. This will be difficult, but not impossible. As Bill Clinton revealed after the Republican landslide of 1994 (a far bigger change than anything wrought by Mr Jeffords) the president's powers of persuasion are immense. And accommodation should be easier now, because the change in the Senate and the passage of a tax cut which is popular with the right should enable Mr Bush to strike deals with Democrats without losing conservative supporters.

But it will require more skill in communications and congressional management than he has shown so far. Mr Bush does not yet have anything like Ronald Reagan's or Mr Clinton's command of the bully pulpit. He remains popular among Republican voters but has done little to bridge the partisan divide that produced last November's tied election. The flat-footed failure of his White House to forestall Mr Jeffords's revolt has also revived worries that his Texan inner circle is unready for the job of managing Washington.

Above all, Mr Bush needs to adjust his policy priorities. He can find common cause with moderate Democrats on Medicare reform, as he did with education. He could co-opt John McCain's crusade for campaign-finance reform (though that proposal still needs improving). He can beat the traditional retreat of presidents frustrated by domestic policies and pay more attention to foreign affairs, and to improving relations with America's allies. And he can make trade-promotion authority (formerly known as "fast track") his top priority, to the benefit of America and the world, and to the discomfort of a Democratic Party split between free-traders and protectionists. Together, these could yet rescue Mr Bush from his father's fate—hogtied by the Senate, and no second term.

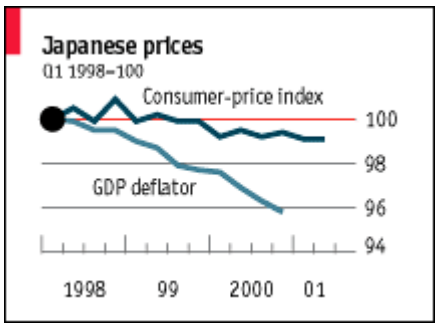
Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Japan's economy

Money still matters

May 31st 2001
From The Economist print edition

The Bank of Japan must do more to support Japan's sickly economy



CENTRAL bankers are often assumed to spring from the same pod, with the same cautious instincts. Yet the contrast between the Bank of Japan and America's Federal Reserve could hardly be greater. After Japan's stockmarket crash in January 1990, the Bank of Japan continued to raise interest rates; it did not start cutting them until July 1991, and then modestly. Contrast that with the Fed, which has cut rates by two-and-a-half percentage points in the past five months. Alan Greenspan, the Fed's chairman, clearly has no intention of copying the Bank of Japan by keeping policy too tight for too long.

That was just the first in a long list of errors by Japanese policymakers. Not only was monetary policy too tight in the early 1990s; more recently the Bank of Japan has also failed to respond firmly enough to deflation. Successive governments have expanded fiscal policy, but in the shape of wasteful public works rather than cuts in income-tax rates that might have improved incentives. Banks' bad loans have been allowed to fester, and deregulation and structural reforms been delayed.

These errors have been costly. The bursting of a bubble as vastly inflated as Japan's was always going to hurt. But with sensible policy the economy should have recovered by now. Instead, Japan has had a decade of stop-go, with average growth of just over 1%, the slowest of all the G7 economies. Japan is not only suffering a cyclical slump in demand; its long-term potential growth rate has also fallen, to only 1-1.5%, thanks largely to sluggish productivity growth. Now the economy seems to have slid into recession once again.

Part of the blame for Japan's woes lies with politicians. Structural reforms have been repeatedly resisted by vested interests within the Liberal Democratic Party. Japan's popular new prime minister, Junichiro Koizumi, now offers hope that Japan will push ahead with the reforms needed to boost long-term growth. But the Bank of Japan remains guilty for allowing deflation to persist. Deflation is a deadly disease in a country where both government and private sector are up to their necks in debt, because it increases the real burden of those debts. Worse, structural reform and a write-off of banks' bad loans may only intensify deflationary pressures.

Short-term pain is an inevitable concomitant of structural reform: it is not an excuse for not doing it. But in Japan, the pain makes it all the more essential to accompany reform with more aggressive monetary easing (see article). The Bank of Japan cannot cut short-term interest rates, which are already zero. But, by purchasing government bonds, it could still affect the economy through inflationary expectations, a fall in the exchange rate and a rise in equity prices. Yet it is reluctant.

The bank seems to be mostly concerned that, by creating inflation, it might let debtors off the hook and thereby reduce the pressure on firms to restructure and on the government to make structural reforms. Yet in playing this game, the Bank of Japan has failed in its primary duty as a central bank: to ensure price stability. Its agenda of pressing for structural reform and corporate restructuring, commendable as it is, is outside this mandate. Structural reform is a matter of political decision, to be taken by a democratically elected government.

Since Masaru Hayami, the bank's governor, has so clearly failed in his main task of ensuring price stability, he should be sacked. The government should also consider altering the terms of the Bank of Japan's law. In particular, it should set a formal inflation target, as is done for some other independent central banks, such as the Bank of England. This would make the bank more accountable to parliament, while not reducing its independence in monetary operations. The Bank of Japan risks dragging the idea of central-bank independence into disrepute. Such independence is meant to be a means to good monetary

policy, not an end in itself.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

India's economy

Unlocking the potential

May 31st 2001
From The Economist print edition

It has achieved a lot over the past ten years. Now India needs a second surge of reform

TEN years ago, facing a balance-of-payments crisis, India's government jettisoned four decades of economic isolation and planning, and freed the country's entrepreneurs for the first time since independence. Growth picked up, inflation fell and India began to recapture some of the ground it had lost in world markets. Since that first burst of radical reform, however, the pace of change has slowed. Progress is still being made, but in hesitant steps, not the bold strides needed to improve upon what some people now call the "new Hindu rate of growth", of around 6%.

By most standards, growth at that rate is fine. It is good enough to make India one of the world's fastest-growing big economies—and good enough to make further reform, with all the difficulty it entails, seem less urgent. This is a pity, because India could and should be doing better still.

Every fraction of a percentage point of extra growth means faster improvements in welfare for the country with the world's largest concentration of poverty. It also means more international clout for India's government—a consideration that may weigh just as heavily with India's nationalist leaders. Moreover, it is just possible that without further reform the new rate of Hindu growth could subside to the old.

Rolling back the raj

Although India became recognisably a market economy in 1991, much was left undone. The combined financial deficits of the central and state governments are near where they were before the 1991 crisis. Governments spend lots of money on subsidies, salaries and interest, little of which helps the poor, and too little on what ought to be their priorities: health, education and infrastructure that the private sector cannot pay for. State-owned enterprises still dominate banking and are the biggest entities in several important industries. Import tariffs remain among the developing world's highest. The "licence raj", which told enterprises what to invest in and how much, has largely disappeared (except in farming) but the "inspector raj" continues to hold the economy back, as do rutted roads and erratic supplies of electricity. The reforms of 1991 showed that the impossible was possible after all, but they did not make the possible easy.

Setting all this right constitutes what Indians call the second generation of reforms, which in some ways will be more difficult to push through than the first (see our survey). One reason is that they require more from the 35 state governments, which account for half the fiscal burden and many of the problems in electricity, education and agriculture, to name a few. Another is that they demand sacrifices from bureaucrats, organised labour and industry, as well as from the reapers of subsidies. India's leaders claim to want to step up the pace of reform, and have done so in a modest way. If they are to go faster, the state will have to reform itself.

Reform of government and administration has no detractors save narrow interests, which resist it silently. It is hard to imagine principled objection to greater accountability of bureaucrats and politicians, the elimination of red tape, and a judiciary with the resources to dispense justice quickly. There are no public defenders of the assorted malpractices that make a mockery of many anti-poverty programmes. Populist subsidies have more beneficiaries and therefore more friends, but the argument against them is

similar: they weaken the state and largely bypass the needy.

Re-engineering the state would reduce deficits, spur enterprise and allow resources to move from wasteful activities to productive ones. It would also speed reforms that rile lobbyists beyond the vested interests: apostles of self-reliance and ideologues offended by globalisation and privatisation. The more people trust the state, the easier it will be to curb its meddling in areas better left to the private sector.

Compete and prosper

Take privatisation. It is easy to denounce sell-offs of state companies when you can plausibly charge, accurately or not, that the seller is in cahoots with the buyer. Reforms such as contracting services out to the private sector and marshalling private capital for infrastructure are open to the same line of attack. There are only two defences: competition where it is feasible and regulation that people trust. The leaders of India's ruling coalition have sounded increasingly eager to privatise during their three years in office. Unfortunately, scandals have weakened their moral authority to do so.

The state needs credibility even more to withdraw protection from the economically privileged. These include organised labour, whose members, once employed, face little risk of being fired; big industry, which wants protection from foreign competition until the government makes it easier to sack workers and enacts other reforms; and small-scale enterprises, which enjoy an array of sops, including protection from competition by big firms in some 800 industries. The interests ranged against opening up draw their justification, if not their motivation, from the argument that a heavy-handed state is the only reliable friend of the poor and vulnerable. Indian history is one of the best demonstrations that this is false. To prove that the opposite is true, though, the state will have to stop squandering resources and start using them wisely.

With $40 billion of foreign-exchange reserves and a current-account deficit of less than 2% of GDP, India may think it can afford procrastination. But a truer index of India's long-term economic health is its public-sector deficit. Although this fell slightly last year, it remains an unacceptable 9-10% of GDP. The deficit reflects deficiencies in tax collection and spending priorities. It pre-empts public investment and discourages private investment by keeping real interest rates high. Unchecked, the burden of public debt could eventually undermine confidence and erode India's comfortable-looking foreign-exchange cushion. To its credit, India's government realises the necessity of reform and has begun to push harder for it. India and the world must hope that it will not take another crisis to give birth to the second generation of change.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

The EU's future

Dreams and discord

May 31st 2001
From The Economist print edition

Grand visions of the future of the European Union are obscuring the crucial question

Get article background

EPA

ONE by one they step forward, the would-be makers of the new Europe. This week it was the turn of Lionel Jospin, the prime minister of France, and Romano Prodi, the president of the European Commission, to offer their ideas. Mr Prodi wanted a "genuine economic government" to make Europe's single currency work better. He also suggested that the EU should raise its budget by direct taxation.

Radical stuff? Maybe, maybe not. On closer inspection, many of Mr Prodi's suggestions are obscure. What exactly would this "economic government" do, and with what powers? Just as unclear are the details of his "European tax in place of the current system of national contributions". Disarmingly, he said that the nature of this tax had yet "to be defined". Indeed. And the definition will be crucial, as would the question of who would determine the rate at which it would be levied.

Mr Jospin's speech was more careful and precise, but it also showed the danger of latching on to grand phrases. The French prime minister proposed a "federation of nation-states"—contrasting his vision with what he said were German ideas for a "federation". Connoisseurs of Euro-babble pounced on this distinction with delight. It just goes to show, they said, that Germany and France are fundamentally divided over the future of Europe; the Germans are eager for further integration, the French are clinging to *la patrie*.

Nonsense. First, the distinction between a "federation" and a "federation of nation-states" is essentially meaningless. Second, Mr Jospin's vision of Europe is in some ways more integrationist than the "Schröder plan", recently released by Germany's ruling Social Democrats. The Germans inflamed Eurosceptics by talking of the need for a "strong European executive". But they also suggested that, though some powers should flow to Brussels, others—notably agricultural policy and regional aid, which together account for 80% of the EU's budget—should be repatriated. By contrast, Mr Jospin sees power flowing only in one direction: towards Brussels. He wants pan-European taxation and social policies. He even appears to suggest that all EU decisions should be made by majority vote—an abolition of national vetoes that would be dramatically integrationist in effect.

Where does that leave the debate? The first conclusion is that the word "federalism" is now more confusing than enlightening in European discussions. To the British it suggests a dreaded super-state. To the Germans it is a way of describing a rational division of powers. To the French it seems acceptable only if combined with soothing talk of "nation-states". Far more useful than using such loaded words as "federalism" is to concentrate on a more precise discussion of responsibilities, to decide exactly what should be done by the EU, and what by the members; that is the crucial issue. Given that national governments still command much more loyalty than the Union—as the EU's own polls show—the fundamental principle should be that the EU should get involved in those areas where there is a clear justification for collective action.

On some cross-border issues—the internal market, competition policy and trade—the EU needs supranational authority, and is already acting as a coherent force. But in too many others the EU's responsibilities seem badly misaligned. It has too much power in some areas, too little in others.

What common European interest is served by devoting almost half the EU's spending to farmers? And why is it so cheerfully accepted that the EU should have common welfare and employment policies, rather than letting them be settled by national preferences, democratically expressed? By contrast,

asylum, immigration and organised crime might better be tackled with common policies.

Mr Jospin's talk of expanding EU capacities in these latter areas sounds promising. But in other respects he is far too ambitious. Europe has no need of a single corporation tax, nor of a single set of "social standards"—though they might well suit France, which would then be able to erase the competitive advantages of other EU countries that are more lightly regulated and taxed. As that old sage Otto von Bismarck once put it: "I have always found people demanding in the name of Europe that which they dare not ask for themselves."

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

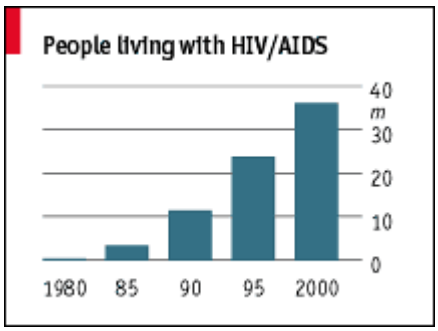
Aid and AIDS

Gambling with lives

May 31st 2001
From The Economist print edition

A fund to help pay for efforts against AIDS and other diseases deserves generous support

Get article background



RICH countries, poor ones, the United Nations, drug companies and non-governmental organisations say they are ready. We can clobber the diseases that kill millions of people each year, says Kofi Annan, the UN's secretary-general. An independent global fund to pay for additional efforts against AIDS, malaria and tuberculosis is well within the means of donors. And though no one has a "magic bullet", good health programmes exist in some poor countries which, if copied, would spread success. But where's the money?

Uganda's education, testing and prevention work seems to have been effective against AIDS; Brazil's use of drugs has limited the spread and impact of the disease. Vietnam, using mosquito nets, drugs and education, has cut malaria rates sharply. The World Health Organisation says 50m tuberculosis cases could be averted in the next two decades given testing, education, political will and drugs. Succeed with health programmes, and you are almost sure also to reduce poverty, especially in stricken Africa and Asia. Reduce the spread of these illnesses and the long-term benefits are enormous.

But, if all agree that a fund is a splendid idea, why won't they pay for it? Mr Annan says $7 billion-10 billion a year, or more, is needed. Opening bids from donors are expected by mid-June, when the UN General Assembly holds a special session on AIDS. But the first signs are not encouraging. Only America, so far, has pledged anything at all: just $200m. Though the European Commission is likely to give more, others, such as Canada and Japan, must come forward too.

Donors have a right to reassurance on two points. First, the money must not be spent on anti-AIDS drugs alone, even though the price of those drugs has fallen recently. The most effective way to fight AIDS, as Uganda seems to have shown, is on a wide front: educating and testing patients, paying for nurses and doctors, giving out condoms, as well as using some drugs. By supporting health systems as a whole, the fund should also bolster efforts against malaria and tuberculosis, and ensure proper monitoring when drugs are used. Drug-resistant strains of diseases are thus less likely to emerge.

Second, the fund itself must not be devoured by a voracious UN bureaucracy. Mr Annan wants an independent board to administer the money, reflecting the interests of donors, recipients, the UN and others. That makes sense. Much of the money would then be channelled through poor countries' own national health structures. But for that to succeed, those countries' governments must be open, honest and ready to put resources where they are most needed.

If Mr Annan can show that his fund will work, the G7 countries should stump up when they meet in Italy in July, and commit themselves to continuing, not just single, payments. The amount of money needed, after all, is not huge: it is about half America's annual spending on pot-plants and flowers.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Britain's election

Vote conservative

May 31st 2001
From The Economist print edition

But choose the ambiguous right-winger rather than the feeble one

THE fact that the most exciting moment of the general-election campaign came two weeks ago, when the deputy prime minister punched a protestor, hardly testifies to a lively or compelling debate. By June 7th most voters, if they care at all, will just be glad that it is over. One task, however, still remains for those who do care—which certainly includes *The Economist*. It is to choose which party to vote for.

If the opinion polls are even approximately correct, then the choice has already been made: Tony Blair's Labour Party will be re-elected, virtually by acclamation. It may even increase its already huge (179-seat) majority in the House of Commons to 200 or more. It may thus be emboldened to hold a referendum on membership of the euro during the next two years, confident it could survive a defeat. To judge by such a situation, unprecedented for any party in British elections let alone Labour, Mr Blair's first term in office must have been a truly remarkable success. The country must be in a state of prosperous contentment, in wondrous admiration of the philosopher-kings who were elected in 1997, and whose innovative ideas have so transformed politics and policy. Yet this is plainly not the case.

Of low expectations and feeble opposition

Four years ago, voters—and *The Economist*—had to compare a tired, ineffectual Conservative government with a Labour Party that promised two main things: to continue many Tory policies; and that "things can only get better". It was an odd mixture of a remarkable break with Labour's past; lacerating criticism of the Tories' 18 years in office; and an apparent determination to occupy much of the Tories' own centre-right ground. We noted that contradiction, and chose to stick with real Tories rather than possible Tories, in the absence of much proper detail about Labour's plans.

Since then, in fact, Labour has been true to many of its words, though not to its more extravagant claims. The party has indeed governed on the centre-right on most issues. Its macroeconomic policy, indeed, has been more orthodox than its Tory predecessors', with more fiscal discipline and the welcome granting of independence to the Bank of England. It has stuck to, and in some ways extended, Tory policies on education. It has dithered over the National Health Service (NHS), but again has not diverted far from the path set by John Major's Tories. In other areas—foreign policy, Northern Ireland, law and order, say—it has been competent but not particularly innovative. On the other hand, Labour has implemented about a third of the programme of constitutional reform advocated in these pages in the 1990s. All in all, Labour has been better than *The Economist* expected.

The results, though, have been modest. Economic growth has, since May 1997, been slower in Britain than in America or in most of the European Union. Unemployment has fallen, but by a lot less than in America. Living standards have continued their steady, but unremarkable rise, albeit trimmed by a higher tax burden. The conditions for private enterprise have improved in macroeconomic terms, but have been worsened by new regulations and tax distortions. Neither the NHS nor British schools are noticeably better. Crime figures have been largely unaffected. Depending on your view, roads and railways have either deteriorated or have finally revealed the effects of previous deterioration.

This is not a bad picture. But neither is it the sort of picture that should justify a standing ovation in next week's election. As if to acknowledge that point, last year the government embarked on a new course of

sharply higher public spending on education, health and transport. Conveniently, the evidence of whether that is working will not become available until well into Labour's second term.

So why, given modest delivery and now delayed gratification, is Labour's lead so huge? One answer is that voters have low expectations of what governments can achieve. Partly that is appropriate—politicians do not have magic wands. But partly it reflects a very British tolerance of mediocrity, of schools and hospitals and railways and jobs that are, well, not very good but not too bad either.

The second, and bigger, explanation lies with the Conservative Party. Since 1997, it has faced a difficult situation: Labour has stolen its policies. It is hard to oppose your own ideas, especially if you are meanwhile hopelessly divided over Europe. Even so, the Tories have made a hash of it. Particularly since Labour's shift back leftwards with higher public spending, they could have mounted a credible attack on high taxes, high public spending and over-regulation. They could have promoted structural reform to improve the public services at lower cost. They could have become "compassionate Conservatives" like President George Bush. Yet instead they chose to neuter their own position on taxes and spending by pledging to match virtually all Labour's plans, and sounded embarrassed when—shock, horror—they appeared to be thinking of cutting taxes. They drove themselves on to shockingly illiberal ground on asylum-seekers and immigration. And their policy on the euro ("save the pound", but just for five years) is laughably mixed up.

Vote Labour, reluctantly

That is why *The Economist* hereby casts its ballot for Labour. Our instincts remain closer to William Hague's: for lower taxes, a smaller state, individual freedoms. But he has failed to make a credible case either against Labour or for his own party. Tony Blair is the only credible conservative currently available. Yet he is as ambiguous as ever. The Blair we support with our vote is the one who admires Margaret Thatcher and has followed many of her policies; who hints that he favours real, structural reform in health, education and welfare, including greater use of private provision; who believes a sharp move to the left in the second term would be electoral suicide, for it would allow the Tories to recapture their old territory. A timid Blair has dominated the first term. A bolder, more liberal Blair is the one we favour in the second.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Letters

May 31st 2001
From The Economist print edition

The Economist, 25 St James's Street, London SW1A 1HG
FAX: 020 7839 2968 E-MAIL: letters@economist.com

Robert Wade replies

SIR – Ian Castles (Letters, May 26th) says that world income distribution has become more equal over the past 25 years. My article ("Winners and losers", April 28th) shows why one cannot make such an unqualified statement. Of the many plausible measures, Mr Castles's statement rests on the one most favourable to the view that inequality is falling. In particular, he uses PPP exchange rates, which introduce a very substantial downward bias. If we are interested in distribution from the point of view of issues such as migration, the marginalisation of developing countries and capacity to repay foreign debts, we should compare incomes with market exchange rates. The conclusion is then unambiguous: distribution became much more unequal over the past quarter-century.

Nancy Birdsall (Letters, May 26th) is right that inequality within developing countries is probably contributing to low growth. The same applies to inequality at the world level. America after 1945 realised that its own growth would be imperilled if it did not redistribute massively to Europe. Today, transfers from rich countries to poor, and downwards redistribution within poor countries, are in the collective interests of the rich countries. Those who say, as you do, that "pulling up the poor still seems a nobler calling than pulling down the rich", overlook this (Economics focus, April 28th). Without downwards redistribution, the rich may not remain rich.

Finally, you say that the world's 600m poorest people saw their share of world income fall between 1988 and 1993 not because of globalisation but because of economic isolation. True. But the question is whether this can best be addressed by "globalising"—that is, by opening their markets, investing in infrastructure, removing price distortions, strengthening the rule of law and establishing western-style democracy. Where government gangsterism prevails, this may be the best that can be hoped for. In more normal states, government should do much more.

Robert Wade
London School of Economics
London

Polluting the Caspian

SIR – There are serious hidden costs in Caspian environmentalism apart from those of oil exploration ("Oil, caviare and worried eagles", May 12th). One derives from the accuracy of reporting; the other from the affordability of environmental sensitivity in nations that are so far below the global poverty line.

The Caspian seals did not die from oil pollution but viral distemper. What should be of concern is that the blubber of dead seals contained levels of toxic DDT far in excess of all safety norms. This lethal chemical is now firmly established in the Caspian food chain after its excessive use on the region's cotton crops during the Soviet period. Both seals and people eat fish, and the death of these seals should be a matter of public health before anything else.

Likewise, the dramatic decline in Caspian sturgeon is mainly a result of overfishing by desperately poor people who have little other choice. The problem is exacerbated by a criminal elite who illegally feed the artificial needs of the luxury caviare markets in the West.

Terry Adams
Cley next the Sea, Norfolk

Equity culture

SIR – It is curious that your survey of equity markets (May 5th) makes a clear case for the importance of capital markets in financing a modern economy while also taking the position that indexing is a superior form of investing.

Particularly in the case of indices weighted by market capitalisation such as the S&P 500, the funds of investors are blindly allocated to the most highly valued companies. The growing popularity of this sort of indexing can become a self-fulfilling prophecy as a disproportionately enormous amount of money flows into the large companies that dominate the index. This comes at the expense of less highly valued businesses that often have a greater need for capital.

John McNear
New York

SIR – The experts all err in looking at valuation models—classic or modern. You are right to call the pageant a "valuation waltz": entertaining but without serious utility. The models are wrong because the morrow is never the same as yesterday. There is only one true measure of value: the market and its shares. You point this out but then decry it as "simple enough" as though simplicity were a fault. Investors study how and why the market arrives at a price to provide them with clues about whether the share is likely to go up or down in the future. Look no further than the market price itself. Simple, but effective and reliable.

John Meehan
Orlando, Florida

SIR – You appear to have missed the only one really relevant measure of equity value: cash flow. The value of an operating asset are the net present value of expected free cash flows discounted to infinity. As a result the most important variables to the price of an asset are the level and future shape of free cash flows, and the discount rate used, which, as you rightly point out, can be analysed in terms of risk premium.

An increasing amount of analysis based on cash flow is now carried out among institutional equity investors to calculate the real cash return on assets. It is then possible to derive a level of economic profit which appears statistically to be the single biggest driver of share-price movement. Analysis based on cash flow would have stressed the over-valuation of the technology sector in the first weeks of 2000 and now warns about over-optimism in the consumer areas.

Pascal Costantini
London

Britain's third party

SIR – Bagehot (May 19th) is blind to the fact that, at least in Scotland, Liberal Democrats are far from being a party that "will not be in government any time soon." The party to which I belong has been part of a partnership government in Scotland that has already delivered 185 of the 270 manifesto commitments made in 1999—notably on the abolition of university tuition fees, free personal care for the elderly, a vast improvement on conditions for teachers and freedom of information.

The example here has been followed by our Welsh colleagues who are now part of a partnership administration there. We can only hope the rest of Britain chooses to follow this example.

Debra Storr
Balmedie, Aberdeenshire

Electioneering in France

SIR – Charlemagne (May 12th) is on firm ground when he comments that "charm, warmth and the popular touch are considerable assets" in winning elections in France and elsewhere. What is less clear is what conclusions French politicians should draw from the fact that "the public...seem surprisingly indifferent to corruption in high places." Surely not that they should fail to observe the exacting standards in public life that *The Economist* rightly has been so robust in championing—in Italy, for

example?

Philip Minns
Paris

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com SPECIAL

In an age without heroes

May 31st 2001
From The Economist print edition

America's defence policy is under review. There are new ideas in plenty, but also plenty of obstacles to reform

ON MAY 25th, when President George Bush addressed the sailors and marines on Commencement Day at Annapolis, his tone veered between high emotion and light-hearted banter. He lauded the courage of an Annapolis graduate of half a century earlier who won the Navy Cross by leading a platoon behind enemy lines in Korea, and he drew cheers by absolving any midshipmen who had been punished for minor acts of misconduct.

But amid all the good humour, the president reminded the budding officers—and above all, their commanders—that a sea-change in American defence thinking is in progress, with potentially enormous consequences for the jealously guarded independence of institutions like the navy and the marine corps, and perhaps for the tradition of heroism which they embody.

In language that might have been copied verbatim from America's more radical military strategists, he called for a "future force that is defined less by size and more by mobility and swiftness, one that relies more heavily on stealth, precision weaponry and information technologies." But perhaps his most telling statement was the preceding one: advances in defence technology must be used "to keep the peace by redefining war on our terms".

This was the nearest thing so far to a manifesto for the searching review that has been going on in deep secrecy at the Defence Department, under the stewardship of Donald Rumsfeld. While saying little in public, the defence secretary— credited by one ex-colleague with "a level of political cunning worthy of medieval Italy"—has been overseeing the work of 20 or so panels, each with a brief to review some aspect of military policy.

The most important, apparently, is a group of brain-stormers headed by Andrew Marshall, an unassuming near-octogenarian whose refusal to be captured by any interest group has given him a formidable reputation for independent thinking. Having spotted the Soviet decline earlier than many other defence specialists, Mr Marshall apparently believes that the Asia-Pacific region, rather than Europe, will increasingly be the focus of American worries about security. In a report he helped to write in 1999, he argued that China, whether weak or strong, is likely to pose a growing challenge to the United States over the next 25 years—and that Japan, and possibly a united Korea, may become reluctant to play host to American bases.

As for the broader review, one of the few conclusions to have leaked out is that the Pentagon should drop or modify its stated goal of readiness to fight two regional wars at almost the same time. In defence politics, this decade-old rule of thumb has become a token of conservatism; so willingness to abandon it suggests that radical change is afoot. But is there really any need, in the immediate future, for the United States to redefine the terms of war, when it is already well placed to prevail in almost any sort of engagement?

Outsiders cannot easily understand why the first months of a Pentagon-friendly Republican administration should be a time of hand-wringing and squabbles for the defence establishment. With more than $1 billion a day to spend, the Pentagon's budget dwarfs those of any of America's allies or antagonists. Expenditure on defence research alone is four times the combined European total. America's lead in the use of sensors and telecoms is so wide, and growing, that one of its biggest problems is stooping low enough to fight alongside its crudely armed allies.

One of its biggest problems is stooping low enough to fight alongside its crudely armed allies

But as Mr Rumsfeld's panels are no doubt reflecting, the aftermath of the cold war has brought plenty of

warnings that America, for all its might, has a soft underbelly which a broad range of enemies might be tempted to attack. It has also pointed up a mismatch between the thousands of ships, tanks and fighter aircraft that America now deploys and the sort of enemy it may face—which may be increasingly primitive, increasingly sophisticated, or a bizarre mixture of both.

The vulnerable giant

Take the problem of access to the battlefield. Although there is little doubt that American expeditionary forces, once deployed, could devastate almost any foe, there are real worries about their ability to gain entry to the theatre of war. An adversary with only a fraction of America's firepower could make it impossible to use bases or ports by attacking them with crude ballistic or cruise missiles or stealthy submarines. Rapid advances in the sciences of surveillance, guidance and propulsion have given America its lead; but those developments may be turned against America in the medium term.

After its high-tech bombing of Iraq and Serbia, the American air force could argue that the United States had found a way of curbing trouble-makers at relatively little cost to itself or risk to its own forces. But whatever its merits, that technique cannot avert humanitarian disasters or fine-tune political developments on the ground. It also works best against a well-organised state that can be induced to sign a peace treaty and implement it; and one that either does not have, or chooses not to use, non-conventional weapons. Future foes may not be so obliging.

In any event, whatever the United States does, other sorts of enemies—the Somali warlords, for example, who turned on America's peacekeepers in Mogadishu in 1993, or Osama bin Laden, a militant Saudi, four of whose followers have just been convicted of attacks on American embassies in 1998—will be making their own attempts to "redefine war" in ways that exploit America's weaknesses.

These include the aversion of its electorate to unnecessary casualties. Especially since the televised humiliation of their soldiers in the streets of Somalia, Americans increasingly feel that their troops should not be put in harm's way unless America's vital interests are at stake. Both among ordinary folk and policymaking professionals, the sense has grown that in a world full of unpredictable foes and unreliable allies, the best hope for American security lies in a stronger emphasis on homeland defence. Taken to its logical conclusion, this could mean sharply reducing foreign bases and deployments—which may be a needless source of vulnerability—and hunkering down in the United States' own territory, while using technology to keep it safe.

Whatever the strategic case for and against, the Bush administration's plan for multi-layered anti-missile defences—on land, sea, air and perhaps eventually in space—draws moral support from this sentiment. As Colin Powell, the secretary of state, found at a NATO meeting in Budapest this week, America has yet to persuade some of its allies of the urgency of the rogue missile threat. But among the keenest backers of homeland defence policy, the fecklessness of allies is yet another reason to put America's needs first.

America has suffered less from terrorism at home than most rich countries

That sentiment may grow if there is any fresh attempt by terrorists to attack targets on American soil. As well as high sensitivity to body-bags, another source of American vulnerability is believed to lie in the very openness of its economy and society, which makes it all too easy for determined fanatics, with or without the help of a rogue state, to mount a deadly attack on its territory—though in fact America has suffered less from terrorism at home than most rich countries. On May 8th, it was announced that Vice-President Dick Cheney would make a renewed effort to co-ordinate all the government agencies involved in responding to terrorism. This may be as big a landmark in security policy as anything happening at the Pentagon.

With more than one Achilles heel, it is certainly understandable that America's military planners should look for ways to profit from their own comparative advantages, including deep pockets and technological prowess, as long as they last. In this spirit, Mr Rumsfeld has already made it clear that he intends to give greater priority to military activities in space: an area where America clearly enjoys overwhelming dominance at the moment, and can probably extend its lead, but may face competition in a decade's time.

Although the idea of space-to-earth strikes with deadly lasers will remain, for the time being, in the realm of science fiction, America's armed forces will certainly rely more and more on guidance from space for the conduct of conventional war. And as part of Mr Bush's plan for multiple anti-missile defence, there may be a revival of his father's concept of space-based interceptors known as Brilliant

Pebbles. “That would be America’s way of playing to its own strengths,” says Jeremy Stocker, a British missile-watcher.

But to what extent can technology, however brilliant, be a substitute for the true grit that is cultivated at institutions like Annapolis? Edward Luttwak, a scholar at the Centre for Strategic and International Studies, reckons the Defence Department should face up squarely to the “post-heroic” age, in which comfortable western city-dwellers refuse to sacrifice their children in wars.

The logical implication, he would argue, is that the Pentagon should cut its conventional force structure—its army divisions, carrier groups and tactical fighter aircraft—and rely more on long-range bombers, missiles and information systems. For the occasional circumstance when a hard military task needs to be carried out at close quarters, America should maintain special forces; but they should be used quite sparingly.

Hard budget choices

One reason, then, for self-examination in America’s defence world is a shift in the international climate and the emergence of new potential threats; another is a shift in American opinion. But even if none of these was changing, Mr Rumsfeld’s Pentagon would still be facing some difficult, and inevitable, budgetary choices.

The Pentagon reckons it has nearly 25% more military depots than it needs

The Clinton administration’s approach to defence often seemed to involve a determination to keep everybody happy. It faced conflicting pressures from the services (army, air force, navy and marines), each of which had its pet arms projects; from its accountants, struggling to balance even so gigantic a budget; and from its allies and foreign-policy managers, who wanted to use America’s forces in an increasing number of small operations, from Haiti to Bosnia. Any attempt to trim the force structure—a full-time army of nearly 500,000, a dozen aircraft carriers and so on—was blocked by the services. And because every military depot sits in some congressman’s district, it has proved difficult to save money by cutting the number of bases, although the Pentagon reckons it has nearly 25% more than it needs.

The Clinton team found itself struggling to satisfy these groups out of a budget which, though rising slowly, was well below the cold-war peak. Inevitably, many were not satisfied. Some critics alleged that petty peacekeeping, notably in the Balkans, was eroding the readiness of the army to fight big wars, although this has been challenged in recent weeks by Charles Moskos, an influential military sociologist. Others argued that the Pentagon was maintaining a bare minimum of readiness by raiding a pool of money that should have been used to modernise the arsenal. In order to keep the services happy, President Bill Clinton agreed to buy a dozen new kinds of “platform”—the generic term for ships, tanks or anything on which weapons and sensors are mounted —but the Pentagon is only in the early stages of paying for them.

For several reasons, the Bush administration cannot carry on down this path. After the “procurement holiday” of the past decade—as weapons ordered during the cold war came into service—the average age of America’s military hardware will rise sharply over the next decade. That will make it more expensive to maintain, especially if it is being used frequently. So if America’s conventional forces are to preserve anything like their present structure, it will be hard to avoid spending hundreds of billions of dollars on new platforms.

Which ones? Some argue that the coming generation of fighter aircraft does not have a long enough range to be much use for conflict in the Pacific, the world’s largest ocean; others, like Michael O’Hanlon of the Brookings Institution, reckon the current mix of weapons, with its aircraft carriers and attack submarines, is well adapted for a time of rising tension there. Either way, the money may soon run out.

Defenders of the current procurement plan will no doubt argue that, in some cases, buying state-of-the-art weapons is no more expensive than reordering old models. But the money to replace the existing fleet, with old weapons or new, will not be there—unless the budget is sharply increased or the force structure sharply cut. Mr O’Hanlon reckons that the Pentagon’s budget will have to rise by $50 billion a year over the next decade simply to pay for arms already ordered and to keep America’s forces at their present size.

So there are strong pressures, as Mr Rumsfeld’s panels are discovering, to axe some procurement

programmes or else make deep cuts in force structure—both for the sake of good housekeeping, and to liberate money for innovation. But that is where the difficulties begin. Each of the proposed new platforms has its own lobby and its own well-argued case.

Take the Joint Strike Fighter aircraft (JSF), so stealthy that on a radar it seems to be no bigger than a golf ball, whose total price tag of more than $200 billion makes it the most costly arms-procurement programme ever. Its production run is intended to be vast, making the unit price sensibly low; and those allies, including Britain, who have earmarked money for the aircraft's development would be furious if it were cancelled. The F-22, another plane competing for defence dollars—about $62 billion of them—is even more elusive; on radar screens, it looks as tiny as a marble. Its role as an air-defence fighter may be hard to justify in post-cold-war conditions, but the air force, having spent billions of dollars on it already, will be angry if this investment is wasted.

A tough slog ahead

For better or worse, Mr Rumsfeld has excluded the interest-groups that usually make defence policy—congressional committees, service chiefs and contractors—from his deliberations. This has helped to shield his strategic review from defenders of the status quo, but has also left him with few friends for the hard struggle (extending well beyond the administration's term) of forcing reform through Congress.

Independent defence-watchers reckon real reform is impossible unless there is some change in the way weapon-building programmes are conceived and executed. At the moment, rivalry between the services distorts the procurement process. The JSF, for example, may lose out in the end because it is not the favoured child of any particular service; it commands less support than, say, the F-22, which is beloved by the air force, or the Super Hornet, the navy's favourite aircraft.

The Pentagon proposes, Congress disposes

What can Mr Rumsfeld do about this? He could abandon his hugely expensive hopes for missile defences—but he will not. Instead, as his appointments at the Pentagon suggest, he will try to curb inter-service bickering. As procurement chief, and as political master of each of the services, he has named people who share his belief in, and experience of, applying the principles of private business to government. And a new management committee (all those officials plus Mr Rumsfeld and his deputy, Paul Wolfowitz) will aim to co-ordinate procurement in a way that reflects America's broad military needs. Business Executives for National Security, a lobby group that has long campaigned for procurement reform, says change for the better may at last be in prospect.

But Mr Rumsfeld cannot alter the fact that, in arms procurement, the Pentagon proposes and Congress disposes. Every line of his plans will be picked over by legislators. Only if the administration can seize the political initiative by laying out some compelling strategic vision will it have any hope of facing down the lobbies and imposing real change.

The most honest thing Mr Bush could say is that, in a globalising world, there is no neat distinction between the security of the homeland and the defence of American interests—with diplomacy as well as cold steel—around the world. The erection of an anti-missile shield over America's territory may or may not be a pipe-dream, but the need to protect overseas bases from crude rockets is pressing and real.

As for hunkering down at home, that is a short-term expedient at best. Overseas bases are not just a target for terrorists, but a token of America's willingness to engage in the world and share burdens with allies. Nor, Mr Bush might add, will any technology entirely eliminate the need for the heroism, flair and calculated risk that was exemplified by John Paul Jones, the founder of the American navy, who lies buried at Annapolis.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

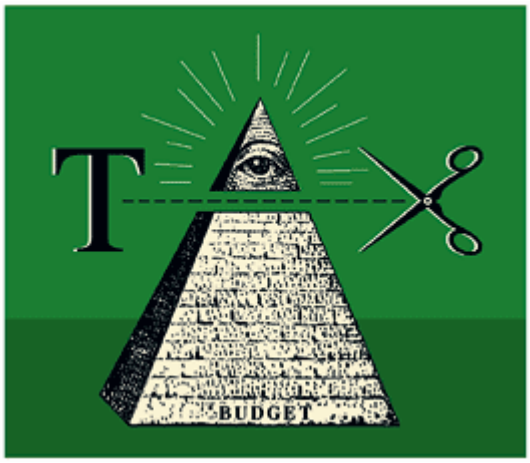
The tax bill

Chicanery, but a boon to Bush

May 31st 2001 | WASHINGTON, DC
From The Economist print edition

Why the Democrats may rue their rush to push the tax cuts through

Get article background



TRANSFIXED by the earthquake in the Senate, many congressmen paid precious little attention to the details of the tax bill they passed on May 26th. The Democrats, in particular, were desperate to get the bill passed, since Jim Jeffords's departure from the Republican Party, and hence the Democrats' sudden ability to take control of the Senate, would become reality only after the bill was out of the way. They may soon rue their urgency. For not only have Washington's lawmakers passed legislation that even by their own low standards is rather awful, but this legislation offers both short-run and longer-term help to Republican tax-cutters.

Most obviously, the law allows George Bush to claim that he made good on his chief commitment in the presidential campaign. Much as he promised in the primaries, taxes are to be cut across four main fronts. Income-tax cuts are the biggest component. There is to be a new bottom tax bracket of 10% on the first $6,000 of an individual's taxable income and the first $12,000 of a couple's, retroactively put into effect as from January 1st 2000. Higher tax rates are to be gradually reduced, with the top rate falling from 39.6% to 35% by 2006. (The 15% tax rate, paid by the majority of Americans, stays the same.)

Just as Mr Bush wanted, the $500 per-child tax credit is gradually increased to $1,000 and, in a sop to Democrats and a few centrist Republicans, those who earn at least $10,000 will get a share of the credit even if they do not pay income tax. After 2005, the marriage-tax penalty is gradually reduced. And, as Mr Bush demanded, the estate tax is repealed, at least in principle (see article). The only provisions not in the original Bush agenda are around $70 billion-worth of education and retirement tax incentives, including a tuition tax deduction and higher contribution limits for tax-advantaged saving accounts.

But the political advantage goes well beyond fulfilling campaign promises. In the short run, the White House will reap the political benefits of fiscal stimulus. The tax bill now includes around $40 billion-worth of tax cuts for this fiscal year (compared with zero in the original Bush plan). This comes mostly from the retroactive introduction of the 10% tax bracket. Beginning in August, and at the administration's insistence, this money will be delivered to taxpayers through a rebate cheque. Cheques will be sent to all Americans who paid income taxes last year, up to a maximum of $300 per person and $600 per couple. With about 9m cheques a week to be sent, this should be done by October.

The rebate process is fraught with practical problems. Cheques will be sent to people who paid taxes last year but are now dead. (Almost 2.5m adult Americans die every year.) People who have moved may not get their cheques.

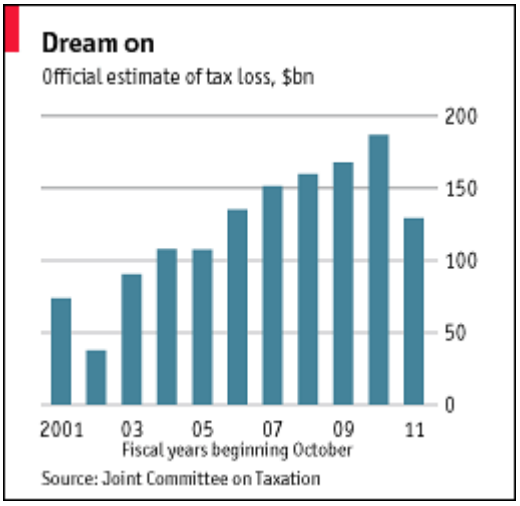
The real question, though, is whether it will provide a boost to the economy. Much depends on whether people save or spend their Bush-given cash. Academic studies of a similar operation in 1975 (in which both Paul O'Neill, today's treasury secretary, and Vice-President Dick Cheney were closely involved) suggest that much of the money was saved. Bruce Bartlett of the National Centre for Policy Analysis, a conservative think-tank, calls those rebates a "total waste of money". But there are reasons to expect more to be spent now. Consumers may see the rebates as a down-payment on future tax cuts. Economic theory suggests that people are more likely to spend a permanent than a temporary tax cut. William Dudley of Goldman Sachs reckons that, if Americans spend half of the fiscal boost, the rate of real personal consumption growth could go up by 0.5% over the rest of this year and into 2002.

Whether or not the rebate produces a fiscal stimulus, Mr Bush may reap a political benefit, largely thanks to Alan Greenspan. If the economy is looking perkier as a result of the Federal Reserve's recent aggressive interest-rate cutting, the White House can still take the credit. If the economy is still sputtering, Mr Bush has created a political shield. Either way, the rebate cheque is a clever political tool to give average Americans a quick fillip from a tax cut whose main benefits will accrue years down the road to top tax-payers.

Over the longer run, tax-cutters could also gain from the gross accounting chicanery with which this bill is crammed. In order to introduce as much tax-cutting as possible, but also stay within the $1.35-trillion ceiling the Senate budget agreement allowed, the tax law is patently dishonest.

Most egregiously, the entire bill now officially lapses at the end of 2010: in other words, the tax cut costs $1.35 trillion over 11 years only if you wave away the last year and assume that all the slashed (or repealed) taxes are reinstated. That is why the official cost of the bill is lower in 2011 than 2010 (see chart). It is also patently absurd, since no one expects the bill's many provisions simply to be rescinded. The same logic applies to provisions, such as the tuition tax credit, that are only temporarily introduced.

Similarly, the bill consciously creates new problems in the tax code. The most extreme is the Alternative Minimum Tax. This tax was originally designed to ensure that affluent Americans did not avoid paying tax by claiming numerous deductions. But a side-effect of the new tax bill is that the number of Americans paying the AMT increases sharply over the next decade. The bill includes a temporary fix until 2004. The result is that the number of people paying the AMT explodes from 5.3m in 2004 to 13m in 2005 and then up to almost 40m in 2010.



Without these accounting tricks, the cost of the tax bill is much higher than $1.35 trillion over 11 years. An analysis by the Centre on Budget and Policy Priorities suggests that the true cost is $1.9 trillion over the 11 years from 2001 to 2011. But this dishonesty has clever political implications.

As well as disguising the full scale of the tax cut, it also creates the prospect of political pressure for more cuts. Whoever is in the White House in 2005, the pressure to fix the AMT (and, in effect, provide another tax cut) will be overwhelming. So will be pressure to keep tuition tax deductions and other tax breaks. Although there is a serious question whether some of the tax changes now scheduled to happen in almost a decade's time (especially the repeal of the estate tax) will actually occur, this bill puts the onus on lawmakers, especially in the early years, to continue cutting taxes.

The Democrats have one powerful tool to counter this tax-cut momentum: the squeeze on spending that will have to accompany it. From education to prescription drugs, Democrats will be able to argue that Mr Bush's tax cut prevents adequate spending on things that voters care about, without dipping into the Social Security surplus that both parties have declared off-limits. Unfortunately, an alternative outcome is that this Social Security surplus will suddenly seem less sacred.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

The “death tax”

Still breathing

May 31st 2001 | NEW YORK
From The Economist print edition

The biggest con of all

Get article background

NOTHING better illustrates the gimmickry of the Bush tax reform than the trumpeted abolition of the estate tax. The “death tax” is now scheduled to meet its end in 2010. Don’t count on it.

America’s estate tax is one of the heaviest in the world, though the blow can be softened by using trusts, charitable foundations, insurance and the like. In recent years, “death to the death tax” has become a rallying cry of congressional Republicans, who last year abolished it, only for Bill Clinton to save it with his presidential veto. Under the Bush reform, the value of an estate at which the tax starts to apply will rise slowly from the current $675,000 to $3.5m, and the rate will fall from 55% to 45%. The tax will then disappear in 2010.

It may seem a remarkable act to reward America’s richest families when inequality is rising rapidly and some of the country’s best-known billionaires (including Warren Buffett, George Soros and David Rockefeller) have publicly opposed scrapping the tax. On closer inspection, though, the whole thing is largely symbolic.

The “sunset clause” agreed to by the Bush administration means that, without further legislation, the estate tax would be restored after one year, in 2011. As Paul Krugman of the *New York Times* has pointed out, if your ailing mother dies on December 31st 2010, you inherit her estate tax-free. If she dies a day later, half the estate is taxed away—which “creates some interesting incentives.”

Moreover, the current “step-up”, which means that assets transferred to heirs are not subject to tax on capital gains generated on the assets during the life of the deceased, will go. So in place of estate tax will be capital-gains tax, albeit at a lower rate. The gift tax, the flip-side of estate tax, designed to minimise avoiding tax by giving assets away during your lifetime, will stay. None of the long-term implications of this combination of changes has been thought through, says Joel Slemrod, a tax economist at the University of Michigan.

Mark Bloomfield, at the American Council on Capital Formation, reckons the reformers were sabotaged by the Joint Committee on Taxation, which at the last minute raised its estimates of the cost of abolishing estate tax by 50%. In the circumstances, the Bush team, urged on by most of the anti-death-tax lobby, decided to pursue the symbolic victory of abolishing the tax, if only for one year, and without step-up, and even though it may be reversed by Congress before it ever happens. The rich might have been better served by lowering the rate of estate tax and raising more rapidly the threshold at which it applies, says Mr Bloomfield.

The battle to scrap estate taxes has barely begun; victory cannot come until it is erased from the tax code. The death tax is dead. Long live the death tax.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Lexington

Tom Daschle to the rescue

May 31st 2001
From The Economist print edition

The new Senate majority leader is bringing hope to the Democrats

FORGET about being born great or achieving greatness. These days the surest way to the top in American politics is to have greatness thrust upon you. George Bush had the presidency thrust upon him by a single vote in the Supreme Court. Now Tom Daschle has had the leadership of the Senate thrust upon him by the defection of a maverick Republican.

The senator from South Dakota has thus become the man who sets the Senate agenda. He can energise his party by introducing measures like universal retirement accounts or universal pre-school education, or torment the White House by blocking Social Security reform or missile defence. Mr Daschle has already declared Mr Bush's scheme to get lots of oil out of the Arctic wilderness a non-starter, and promised to make a patients' bill of rights the first item on his agenda.

This is not the only reason why Democrats are cock-a-hoop. Mr Daschle has solved the problem that has been sapping the party's energy since January. For the past four months, journalists looking for the public face of the Democratic Party have been confronted with a menagerie of camera-hogs such as the slippery Terry McAuliffe or the fearsome James Carville. Now they have a single face.

And a rather attractive face it is. Mr Daschle is a "prairie populist". He was born in a small windswept town in South Dakota (his father was a book-keeper; the town's main street was called Main Street). He spends three weeks every year driving around the state unencumbered by handlers. He walks a middle line between his party's interventionist and New Democratic wings. His mild-mannered and plain-spoken style, combined with his instinctive cultural conservatism, will make it harder for the Republicans to present the Democratic Party as the tool of bossy people from the east coast or the west.

Mr Daschle's elevation has increased the likelihood that the Democrats will make gains in next year's congressional elections. The party that does not control the White House almost always picks up votes in the mid-terms, as the Republicans did spectacularly in 1994 (though they have been losing ground in the Senate since then). Now the Democrats are even better placed. The party that controls the Senate finds it easier both to persuade incumbent senators to stay on (all those committee chairmanships) and to persuade challengers to run.

Yet, for all that, the Senate still contains the same hundred members that it did a week ago. And it remains exactly the same organisation: a self-important body that treats its members like demi-gods and requires a super-majority of 60 votes even to break a filibuster.

Mr Daschle will have a hard job keeping his own party in line and attracting stray Republicans. He will find it even harder to strike the right balance between co-operation and obstruction. If he blocks everything that Mr Bush sends him, he risks alienating moderates and increasing popular resentment. If he co-operates too enthusiastically, he risks alienating the core of his party, which is baying for Mr Bush's blood.

If anybody can perform a miraculous balancing act, it is Mr Daschle. He is a past-master at squeezing the maximum of power from the narrowest of margins. He won his first race for Congress, in 1978, by a mere 139 votes after a hand recount and a prolonged legal wrangle that reached the state's Supreme Court. He won a contest for the Senate minority leadership in 1994 by a single vote, and one of his backers bolted soon afterwards to the Republicans. But his skill in holding the caucus together through the traumas of the Gingrich revolution and the Clinton impeachment earned him the unanimous support of his party. "I was totally wrong about this young man," says Senator Robert Byrd (83). "He has steel in his spine, despite his reasonable and modest demeanour."

Mr Daschle has held his fractious caucus together by relying on quiet dialogue rather than Bush-style intimidation. His leadership team stretches from moderates like John Breaux to liberals like Barbara Boxer, and he has resolutely refused to take revenge on renegades like Zell Miller, who has voted with the Republicans more frequently than with the Democrats. He suffered a significant defeat when 12 Democrats voted in favour of Mr Bush's tax cuts, of course. But he partly made up for it by heading off a rebellion over campaign-finance reform and then by wooing Jim Jeffords. His lovey-dovey relationship with John McCain is tormenting the White House.

This stellar record, however, could create Mr Daschle's biggest problem: inflated expectations. It is not surprising that Democrats are eagerly comparing him to George Mitchell, the Senate majority leader who destroyed the first Bush administration in the battle of the two Georges. Mr Daschle is not only Mr Mitchell's protégé. He also shares his soft-spoken manner.

But Mr Mitchell enjoyed the luxury of large majorities in both the Senate and the House. He was also up against a much less skilful opponent, who simply sat back as Mr Mitchell forced him to break his "no new taxes" pledge. Mr Mitchell's dismemberment of George Bush senior's administration persuaded all too many people, Republicans as well as Democrats, that power in Washington had shifted inexorably from the imperial presidency to the newly imperial congress.

The disaster of the Gingrich revolution proved just how wrong this analysis was. The White House still controls the most important instruments of power: the government apparatus, the attention of the press corps and the capacity to set the agenda. Bill Clinton humiliated both Newt Gingrich and Trent Lott, despite Republican majorities in both houses and his own errant behaviour. The betting is still that Mr Bush, too, can prevent Mr Daschle from earning a place in his party's pantheon beside his former mentor. But Mr Bush will have to show sharper political skills than the ones he has displayed in the past few weeks.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Land-grant universities

An old dream in trouble

May 31st 2001 | MINNEAPOLIS
From The Economist print edition

A very American institution tries to survive in the Information Age

THE president of the University of Minnesota is not a happy man. Mark Yudof recently asked the state legislature for another $221m for his university. In a blustery fit of fiscal conservatism, Minnesota's governor, Jesse Ventura, said it should get only a quarter of that. As the legislature squabbles over its budget proposal, the Minnesota House's offer of $64m is only $8m above the governor's, and the Senate is prepared to stump up only $138m.

The University of Minnesota is one of 105 "land-grant" colleges established on land donated by the federal government to serve the good of America. Altogether they educate around 1.3m of America's current total of 15m students. A quarter of the land-grant universities are now private; but the rest, including the University of Minnesota, are state institutions.

Mr Yudof's annual budget is $1.9 billion, about a third of which comes from the state, the rest from tuition fees, federal grants, partnerships with private industry and so on. He wants that extra $221m to help him attract better teachers and sharpen up his science courses. He sees the university as an economic engine for the region, a centre for its knowledge workers—and, as always, the farmers' loyal friend. For Mr Yudof, anything less is a "formula for a third-class university".

Other land-grant universities are feeling the same cold wind. Public universities in general, which used to cover most of their budgets from state money, now get only 15-30% from that source. Their costs are rising rapidly, especially where new technology and health-care expenses are concerned. To fill the gap, many of them are looking to the private sector for help. But can they do this and still stay loyal to their old public responsibilities?

In 1862, reckoning the pioneers would be heading out west again when the civil war was over, Abraham Lincoln signed into law a momentous piece of legislation called the Morrill act. This granted 30,000 acres of land to each state for each member of Congress that it sent to Washington. This land was to be used to build universities, and also as a form of endowment for them.

A second Morrill act in 1890 forbade racial discrimination in these places. Justin Morrill, a high-school drop-out and the author of both acts, intended the land-grant universities to educate ordinary Americans. They were to be the scaffolding within which would arise a polished, prosperous and democratic society.

Arnold Toynbee, a British historian, thought the land-grant universities were America's one original contribution to higher education. Whereas, in Europe, most universities at that time existed to provide the upper classes with a training in the liberal arts and religion, the land-grant colleges set out to educate a broad swathe of middle America. They reflected many Americans' dissatisfaction with what they saw as the snootier sort of education—inherited from England—that was provided by Harvard, Yale and so on.

The new universities would not forsake the liberal arts. But their main job was to train those westbound pioneers in more practical skills, such as mining, engineering and farming. Over time, the skills they taught broadened in range. It was a University of Minnesota researcher who in the 1950s created the world's first pacemaker, which led on to other devices such as defibrillators and neurological stimulators.

The arrival of the knowledge economy, argue the land-grant universities, means that their mandate should become even broader. "If higher education was ever a luxury, that day has long since passed," is the belief of Brit Kirwan, president of Ohio State University.

Between 1980 and 2000, part-time enrolment in higher education increased by 27%, to 6.3m students. Between 70% and 90% of Americans surveyed by the National Association for State Universities and Land-Grant Colleges have recently had some additional education. But the work is far from complete.

Only 7% of poor people get university degrees; only around one in ten blacks and Latinos get them.

The land-grant colleges now want to improve the education they provide in all the modern technologies; they hope to become as good as places like Stanford and the Massachusetts Institute of Technology. They are increasing their tuition fees to meet rising costs at a time of slack public support. But fees are not enough. Short of public money, they therefore find themselves accepting an increasing pile of corporate dollars. And private-sector support rarely comes without strings attached.

Back in fashion

All this is held to threaten the original purpose of the land-grant university. So support is growing for a modern equivalent of the Morrill act. Some years ago the presidents of a number of land-grant institutions, plus various other interested parties, formed a group called the Kellogg Commission to discuss the new demands that were changing their campuses. This commission is now proposing a massive recommitment to the principles of the Morrill act in the form of a “Millennial Partnership Act”. If it becomes law, this would provide more than $1 billion a year in new federal money, and as much again from the states.

The project’s supporters are currently drafting a bill and trying to work out how much support they have in Washington, DC. They are tentatively eyeing Senator Jim Jeffords of Vermont as one potential ally. Present notoriety apart, he is not a bad choice, since he has served on the Senate Finance Committee and was the senior Republican on both the House and Senate Education Committees. And he talks kindly of his predecessor’s legislation. His high profile might not hurt either.

While Washington ruminates, Mr Yudof and his colleagues plod on, trying to make up for the lack of state money with bigger tuition fees and a growing dependence on the private sector, while at the same time hoping to preserve their institutions’ original purpose. Whether they will in fact go on performing that function depends partly on the politicians in the nation’s capital—not least on President George Bush, who came into office proclaiming his determination to improve America’s system of education.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Atlanta

The city laid bare

May 31st 2001 | ATLANTA
From The Economist print edition

A trial reveals Atlanta's bad side

EVEN the writers of the "The Sopranos", Rudy Giuliani's favourite TV viewing, would be hard-pressed to come up with a plot-line to rival the trial of Steve Kaplan. Mr Kaplan, a strip-club owner, is on trial with six others in Atlanta on racketeering charges. His trial, which began on May 14th and is expected to last for months, has everything: shady sex, frightening bouncers, secret cash payments and special guest appearances by Mafia dons.

Mr Kaplan's Gold Club, which makes $20m a year, is the most notorious strip-club in a city crawling with them. Celebrities such as Madonna and Mick Jagger have visited it. The Gold Club is popular with professional athletes: several of them, including basketball's Patrick Ewing and football's Terrell Davis, have been subpoenaed.

The athletes, according to the US attorney's office, got sexual favours from dancers; Mr Kaplan even flew several dancers to Charleston to entertain the New York Knicks. Prostitution is on the list of charges against Mr Kaplan, as well as credit-card fraud (some customers say more than $20,000 was charged in two hours), bribery of the police, obstruction of justice and seeking "protection" from the Gambino crime family. Michael "Mikey Scars" DiLeonardo, accused of extorting money from Mr Kaplan for the family, is a co-defendant.

It is not the first time that Mr Kaplan has been linked to the Mob. John "Junior" Gotti, leader of the Gambino family, sometimes visited a night-club Mr Kaplan owned in Boca Raton, in Florida, during the early 1990s. A self-confessed Mafia-employed torturer who worked at the club alleges that Mr Kaplan financed a loan to a cousin of Mr Gotti, and would himself pick up Mr Gotti at the airport. Just friends, say the defence lawyers. Mr Gotti, serving his own sentence for fraud, was transferred from New York to Atlanta before the trial began, though observers think it unlikely he will testify.

The defence lawyers, a flamboyant lot, respond to all this with allegations of bias and incompetence. One lawyer, representing a former dancer for the Gold Club, climbed on a table and took off his jacket, pretending to be his client. Mr Kaplan's own lawyer had words with an FBI agent, who later threw a videotape at him.

For all its theatrics, the defence seems to believe that the charges against Mr Kaplan may not stick. It hopes to prove that most of the government's witnesses were either coerced or bribed, with shorter sentences, by over-zealous FBI agents. In opening statements it mentioned the FBI's failure to turn over documents in the Timothy McVeigh case. If the prosecution does indeed fail, all that Atlantans may take away is the memory of a soap-opera trial—and a reinforced picture of American law-enforcement as conviction-hungry and incompetent.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Power politics

Westward ho!

May 31st 2001 | LOS ANGELES
From The Economist print edition

EPA

Politicians beware: Californians are cross

ENOUGH blossom still clings to the jacaranda trees to mist the streets with Impressionist blue, but it is the rather less lovely art of politics that has lately dominated the view in Los Angeles. On May 29th George Bush, on his first visit to California since his election, met Gray Davis, the governor, to discuss the electricity shortage that grips the state.

Mr Davis has been clamouring since the autumn for caps on the wholesale price of electricity. On the spot market, where California has to buy much of its power, these prices have surged to over ten times their former levels, driving the state's largest utility into bankruptcy and draining the budget. Mr Bush has repeatedly said that he thinks price caps will only make California's problems worse, by reducing the incentive for power producers to build more capacity. This week, neither man changed his tune.

Instead, Mr Bush offered more energy saving in federal buildings, $150m more to help poor families pay their fuel bills and help to improve the state's transmission lines. Mr Davis, clutching a supportive letter from a posse of economists, insisted that only price caps will avert a recession, and announced that California will sue the Federal Energy Regulatory Commission (FERC), which he claims is legally required to introduce them.

The one point they could agree on was that it is extremely odd that the same amount of natural gas piped from Texas should cost $5 in New York and $15 in California. Mr Bush will order the newly appointed director of the FERC to look into it. This is a shrewd concession, as it helps defuse the accusation, voiced by Democrats, that California's problems are part of a Texan plot designed by cronies of Mr Bush.

Neither man has much credibility in the state these days. A Field poll released before their meeting showed that Mr Davis's standing has plummeted since the crisis began. A mere 42% of Californians think he is doing a good job, compared with 60% four months ago. Mr Bush had less far to fall, but is doing little better. The Field poll puts his support at 42% too.

Winning popularity in California is less pressing for Mr Bush than for Mr Davis (although some of California's beleaguered congressional Republicans, facing elections next year, hope he will give way on price caps before the summer power cuts are over). The governor must confront the voters next year, and his re-election no longer looks inevitable. After years in which no Republican could come close to him, a potential rival looms in Richard Riordan, the current mayor of Los Angeles.

Mr Riordan will be free to run because his eight years in office are ending soon. On June 5th, Angelenos must elect a successor from two Democrats. One, James Hahn, the city attorney for 16 years, is likely to maintain the status quo. His opponent, Antonio Villaraigosa, has risen rapidly from a background of left-wing politics in Latino East Los Angeles to the speakership of the California Assembly between 1998 and

2000. He has the endorsement of Mr Riordan and of the *Los Angeles Times*, and his charisma and energy make up for a lack of certainty about how he would run the city.

Whoever wins, there will be a new hand for Mr Bush to shake on his next visit. That visit may not have to wait very long. As summer heats up, the west coast will be shouting ever louder for his attention.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Colombia's internal conflicts

War comes to the cities

May 31st 2001 | BOGOTA
From The Economist print edition

AP

A rash of urban bombings has highlighted a new security threat

Get article background

DESPITE all the mayhem in Colombia's countryside, its cities have been relatively peaceful in recent years. So a wave of urban bombings over the past month has shaken Colombians, and brought new fears that the murderous battles between left-wing guerrillas and right-wing paramilitary vigilantes are reaching the cities, where 70% of the population lives. That is yet another worry for President Andres Pastrana and his vice-president, Gustavo Bell, who on May 29th was also given the job of defence minister.

Four days earlier, two dynamite blasts outside Bogota's National University killed four people and injured 26. May had seen other bombs. An explosion outside a hotel in Cali, Colombia's third city, injured dozens of people. A bomb in a rich suburb of Medellin, the country's second city, killed eight people and injured more than 130. Not since Pablo Escobar, the late boss of Medellin's drug mob, waged a murderous campaign a decade ago against extradition to the United States have Colombia's cities faced such a wave of terrorism. This time it is less clear who is responsible. Indeed, it seems unlikely that all the bombs come from the same source.

Nobody has claimed responsibility for the Bogota blasts, and the security forces refuse to comment. The local media have speculated that the urban militia of the Revolutionary Armed Forces of Colombia (FARC), the main guerrilla group, was the most likely perpetrator. The police do have a hypothesis about the Medellin bomb. They say it was part of a feud between Carlos Castaño, the leader of the right-wing vigilantes of the United Self-Defence Forces of Colombia (AUC), and the city's largest criminal gang (known as *La Terraza*). The two were once allies; indeed, both prospered under Escobar's sway. But the police say they fell out last year, over $10m from a drug deal.

Mr Castaño has claimed responsibility for a huge 230kg (506lb) remote-controlled bomb placed outside the Bogota offices of a communist newspaper in mid-May. The device, defused by the police, was a protest, he said, against the appointment of the paper's editor to a committee set up by the government and the FARC, as part of their peace talks, to study measures to combat the AUC. The police said that the bomb, hidden in the back of a fruit truck, could have laid waste two whole city blocks. The security forces have defused four smaller devices over the past fortnight.

A call for wider powers

Having divided up much of the countryside between them, the rebel armies of right and left have begun to fight over some urban areas. Worst hit has been Barrancabermeja, an oil-refining city of 283,000

people, where 216 people have been killed this year in a struggle in which the AUC has largely dislodged the National Liberation Army (ELN), the FARC's smaller cousin, from working-class neighbourhoods. Mr Castaño said recently that he had set up an "urban front" in Bogota, too, where the police say the FARC and the ELN have 130 armed militiamen.

After several massacres by the AUC, the government is trying to curb it: 326 AUC members were arrested in the first four months of this year, three times as many as in the same period last year, according to the defence ministry.

The bombings have led to calls, especially from General Fernando Tapias, the head of the armed forces, for Congress to pass a controversial anti-terrorist bill. This measure, already approved in the Senate, would give the security forces wider powers of arrest, transfer responsibility for investigations of deaths in combat from the attorney-general's office to the armed forces, protect the armed forces from investigations by the ombudsman, and regulate private security guards.

Supporters say that such measures are essential to fight a counter-insurgency war in which the army lacks numerical superiority and must comply with a democratic constitution. But opponents claim that the bill would break international human-rights agreements and, by intensifying concern about the armed forces' human-rights record, might jeopardise foreign aid to Colombia.

Such fears appeared to lie behind Mr Bell's appointment as defence minister. His predecessor pushed through measures to turn the army into a more mobile and professional force. As vice-president, Mr Bell, a former law lecturer, was responsible for government relations with human-rights groups. In his new job, he must walk a tightrope between human-rights and military concerns—something the bombings have made no easier.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Peru's election

Known devil v unknown devil

May 31st 2001 | LIMA
From The Economist print edition

The voters find it hard to decide which man they dislike least

Get article background

DEMOCRACY sometimes disappoints. So it is in Peru. In a run-off ballot on June 3rd, Peruvians are due to choose a successor to their disgraced former president, Alberto Fujimori. They seem to find both the candidates—Alejandro Toledo, a centrist economist of Andean Indian origins, and Alan Garcia, a populist former president—equally unattractive. The opinion polls show neither man clearly ahead, and suggest that up to a fifth of voters are likely to abstain in disgust.

According to Apoyo, a polling company, 41% support Mr Toledo and 38% Mr Garcia, with 21% planning a spoilt or blank ballot. Other polls give Mr Toledo a wider lead. But Alfredo Torres of Apoyo says that he does not rule out a victory by Mr Garcia, who may have a "hidden" vote.

The election had long seemed Mr Toledo's to lose. He topped the poll in its first round in April, with 36.5%, against 25.8% for Mr Garcia. Last year he narrowly lost a rigged election to Mr Fujimori, waging a long and sometimes lonely fight against an authoritarian regime. That regime suddenly collapsed amid scandal six months ago. But Mr Toledo's own flaws have robbed him of support.

During an unusually dirty campaign, Mr Toledo has faced claims that he took cocaine, refused to recognise an illegitimate daughter and frequently tells lies, even about politically irrelevant matters, such as the date of his mother's death. He has also been let down by an unpredictable temper. Having remained calm in a debate with Mr Garcia, who is a polished orator, he then spoilt matters by interrupting a television interview with his opponent with an irate telephone call.

Support for Mr Garcia began to rise after the debate, particularly among those who had earlier said they would cast blank votes. Many of them, especially those in poor villages and urban shanty towns, were supporters of Mr Fujimori. Now they fear the loss of aid schemes. Mr Garcia has promised an emergency job programme, the enforcement of the eight-hour working day, and lower electricity and telephone tariffs. Though his pledges do not differ much from his opponent's, he has proffered them more effectively.

Mr Garcia, however, remains anathema to many older Peruvians who remember his tenure from 1985 to 1990, which was marked by hyperinflation, terrorism and, according to his accusers, corruption. Mr Toledo's supporters have unearthed evidence that Mr Garcia is buying an expensive flat in Paris, although he has said he owns no property abroad. Evidence has also come to light of payments a decade ago totalling $2.6m to bank accounts in the United States linked to Agustin Mantilla, a close associate of Mr Garcia's. Mr Mantilla denies any wrongdoing. However, he does appear in a secretly-filmed video, taking money from Vladimiro Montesinos, Mr Fujimori's intelligence chief.

Whoever he may be, it is plain that Peru's next president will have the support of only a minority of the electorate. His first job will be to persuade more of his countrymen that he deserves the job.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Argentine politics

Menem's dates

May 31st 2001 | BUENOS AIRES
From The Economist print edition

One's with a judge

IN SLUMP-STRUCK Argentina, Carlos Menem might have hoped that the glitzy ceremony on May 26th in which he married Cecilia Bolocco, a Chilean former Miss Universe, would make voters hark back to the wild economic booms of his ten-year rule. Certainly, it was a reminder of what Argentines most admire in the septuagenarian ex-president: his ability to pull blondes half his age and twice his height.

Reuters

Ex-presidents prefer blondes

But not all turned out as planned. Mr Menem's piqued daughter had banned the couple from using the family's mansion, registered in her name. Worse, the groom has a date in court. A judge investigating allegations of illegal arms exports to Croatia and Ecuador in the early 1990s has ordered the arrest of two of Mr Menem's closest aides, Erman Gonzalez, a former defence minister, and Emir Yoma, his first wife's brother. Both are in jail. Mr Menem is due to give evidence himself in July. He may be arrested before then.

Many senior figures from Mr Menem's Peronist party, including the governors of the three largest provinces, stayed away from the wedding. With an eye on the presidency, they might be happy if the investigation ended Mr Menem's fading hopes of a comeback in the 2003 election.

But neither the Peronists, nor President Fernando de la Rua's governing Alliance, has much appetite for the political stress that an indictment of Mr Menem would bring. During his presidency, Argentina's judges were notoriously pliant. His chances of marital bliss may depend on whether they still are.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Mexican politics

The dinosaurs suffocate

May 31st 2001 | MEXICO CITY
From The Economist print edition

The PRI looks wearier than ever

WHEN, 65m years ago, an asteroid that fell near the Yucatan peninsula wiped out the world's dinosaurs, it did not exterminate them all at once, but triggered changes to the atmosphere that gradually killed off the survivors. Likewise, defeat in last year's presidential election ended seven decades of rule by the Institutional Revolutionary Party (PRI) but did not kill it. However, in Mexico's more democratic atmosphere, traditional PRI leaders, known as "dinosaurs", are slipping away one by one. And with them goes much of the party's political strength.

The latest blow came, appropriately, in Yucatan. The state's outgoing governor, Victor Cervera, was known for mass handouts of bicycles and washing-machines. He called them "credit schemes"; vote-buying, said opponents. By tinkering with the state's constitution, Mr Cervera had managed to be the only state governor in Mexico to have served more than one term. He then tried to rig the election for governor held on May 27th by imposing a biased state electoral institute—and defying President Vicente Fox and the courts to stop him. He lost, and justice prevailed. Preliminary results showed Patricio Patron of Mr Fox's National Action Party (PAN) defeating the PRI's Orlando Paredes.

The result was not just a personal defeat for Mr Cervera. Seen even by many in the PRI as an archetypal dinosaur, he is hugely popular in Yucatan. He attracted *maquiladoras* (export-assembly plants) to the state. These usually congregate on Mexico's northern border near their main market, the United States, but now employ 34,000 people in Yucatan.

That Mr Cervera's popularity could not guarantee a PRI victory shows how much the party has lost its appeal among an ever-younger electorate. The PRI knows it has to do more to court the young: "I'm 44," laughs Ildefonso Guajardo, a PRI congressman, "and in the PRI, I am considered a member of the young generation."

Until 1989, the PRI had never lost a state election. Since 1999, it has not won any, and its lingering hold on Mexico's states is slipping away (see map). This year elections will be held in two more PRI strongholds: Tabasco, in August, and Michoacan, in November. The PRI will probably lose Michoacan to the leftish Party of the Democratic Revolution (PRD), and polls give it only a slight lead in Tabasco (a replay of a disputed election last December). Losing both states on top of Yucatan, says Joy Langston, of CIDE, a Mexico city university, would dent the PRI's credibility so badly that it might start to break up.

Any recovery for the PRI depends on internal renewal before the congressional election due in 2003. Last month the party held its first-ever election for a general secretary. But it needs to do far more to democratise itself and to create a distinctive ideology. The first test of that will come in a national conference set for November. Ambitiously, at least a third of the 10,000-12,000 delegates are supposed to be under 30; a third must also be rank-and-file members, not party officials. If that meeting cannot precipitate the PRI's evolution into a different political beast, it will soon go the way of the dinosaurs.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Brazilian politics

The mighty, fallen

May 31st 2001 | SAO PAULO
From The Economist print edition

The decline of a once invincible politician

JUST months ago, Antonio Carlos Magalhaes was Brazil's second-most-powerful political leader. Indeed, opponents taunted President Fernando Henrique Cardoso over being bossed around by "ACM", as he is known in Brazil. But on May 30th a political career spanning half a century came to a sudden halt, when Mr Magalhaes resigned in disgrace from the Senate.

His downfall was triggered by his desperation to destroy his arch-rival, and successor as Senate president, Jader Barbalho. In February Mr Magalhaes visited federal prosecutors seeking mud to sling at Mr Barbalho. But he let slip that he had arranged for the extraction from the Senate's voting machine of a list of who voted which way in a supposedly secret vote last year to expel one of Mr Barbalho's colleagues over corruption accusations. That led eventually to a decision last week by the Senate ethics committee to recommend the expulsion of Mr Magalhaes. To avoid that fate, which means an eight-year bar from office, he resigned.

Mr Magalhaes's career was based on ingratiating himself with, and then manipulating, whoever was in power. His supporters acquired a near-monopoly of public positions in his home state of Bahia, in the north-east, during Brazil's 1964-85 military dictatorship, which appointed him mayor of the state capital, Salvador, and then state governor twice. As communications minister in the late 1980s, he developed close relations with Globo, Brazil's most powerful media group. His own media assets, allied to Globo's, provided sympathetic coverage, and received most of the state government's advertising.

Mr Magalhaes's fall has been swift. In March Mr Cardoso threw his allies out of the cabinet. Globo is now showing a satire that lampoons him as "Senator Fraudalhaes" as well as a soap opera about a dodgy north-eastern politician. He claimed he would return to the Senate, though he seems more likely to retreat to Bahia, where a recent poll found 70% would still vote for him as governor.

Mr Magalhaes's downfall has been awkward for Mr Cardoso, whom he has criticised for allegedly tolerating corruption. It has weakened the president's four-party coalition, and comes on top of an impending energy shortage and economic worries. But Mr Magalhaes's departure from Brasilia suggests that an era of all-powerful political bosses is ending.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Indonesia

Megawati makes her move

May 31st 2001 | JAKARTA
From The Economist print edition

Parliament has called for an impeachment session by early August, but Abdurrahman Wahid's presidency is already finished

AP

Get article background

SOME time in the next two months, Megawati Sukarnoputri will complete her takeover of Indonesia's government. If any doubts about her intentions remained, she squashed them this week by refusing to discuss a compromise with Abdurrahman Wahid, the current president, before a parliamentary vote on his future. Instead, Miss Megawati's Indonesian Democratic Party (PDI-P) led the charge on May 30th, as parliament voted by 365 to four to press ahead with its impeachment drive against Mr Wahid. Members of Mr Wahid's own party walked out before the vote, and others abstained.

The parliamentary vote paves the way for a special session, starting on August 1st, of the same People's Consultative Assembly (MPR) that handed Mr Wahid the presidency 19 months ago. It is Indonesia's supreme body, being a presidential electoral college and the constitution's interpreter rolled into one. Since parliament's 500 members are much the largest component of the 700-member MPR, if Mr Wahid holds out to the last, he will surely be unseated. And then, as vice-president, Miss Megawati will take over.

No doubt more offers, counter-offers, refusals and denials will follow in the next few days and weeks. But none of that will prevent Miss Megawati's ascent to power. Instead, only three issues—all closely related—remain undecided. Will Miss Megawati formally become "president", or accept some other term to describe her new role as head of government, leaving Mr Wahid with an empty title? Will Mr Wahid resist to the end of the road, or accept a less humiliating exit? And will the violence that occurs so often in Indonesia spin out of control?

Those questions remain unanswered because Mr Wahid remains the only person in Jakarta who has not yet understood that the game is up. As parliament met this week, he continued to defend himself as though someone might still be listening. In a letter to parliament before the vote, he responded to its previous censures by complaining that it had "failed to specify what pledge of office has been violated". This was a fair point, since the corruption probes that triggered the impeachment process found no evidence that he had personally benefited from a pair of multimillion-dollar scandals. But parliament did not care.

Since Indonesia's political system is nominally presidential, though in practice a bit of a hybrid, parliament is using the language of impeachment to dump Mr Wahid in what is in some ways closer to a vote of no confidence. His parliamentary critics have been taking care to mask this fact by accusing him,

rather vaguely, of failing to uphold the constitution or fight corruption. As they have realised that nothing can stop them, however, they have grown franker.

Akbar Tandjung, parliament's speaker and head of its biggest party after the PDI-P, said this week that Mr Wahid is being impeached for his "performance, attitude and policies". Another MP who helped draft the charges admits that "we tried to make it as general as possible to make it as difficult as possible for the guy to escape...Whatever accountability speech he makes, he won't pass."

Mr Wahid has no remaining authority—political, executive or moral—with which to fight back. His National Awakening Party controls only 10% of parliament's seats. He has done nothing to restart the economy, tackle corruption or give Indonesians a reason to feel secure about their future. Even worse, as the impeachment process has enveloped him, he has behaved more like a tottering tyrant than as the pluralist democrat he once appeared to be. He frequently hints that thousands of his loyal supporters will riot if he is removed. This week, they went on the rampage in east Java, and tried to invade parliament while it was in session.

Although he has never quite said it outright, Mr Wahid has also flirted with the idea of invoking emergency powers. The strongest defence that his supporters can offer is that he does not mean what he says and that he expects people to ignore him: hardly the hallmark of a good president.

As a result, Mr Wahid's main accomplishment this year has been to make Indonesia's armed forces seem patriotic. The generals are already delighted that Miss Megawati will take power. She is a staunch nationalist and will probably do little to hold them accountable for violent crimes or corruption. Yet Mr Wahid has given them a bonus. Every time a civil emergency looms, the generals have a chance to declare that it would be undemocratic and disloyal to the Indonesian people to carry out an order to enforce it—as much as they would like to help the president. Indeed, in a recent poll Mr Wahid was judged less popular than ex-President Suharto, the autocrat who suppressed and plundered the country for three decades.

With Mr Wahid so weakened, Miss Megawati can afford to dictate terms. After this week's vote, any graceful exit she offers him will be seen as a show of mercy. She has reasons to try. By keeping Mr Wahid as a figurehead, she could deflect some of the fire she will no doubt draw upon assuming power. It might also pacify Mr Wahid's supporters, thus making her transition more stable. But if Mr Wahid refuses a deal, Miss Megawati seems to have few qualms about using Indonesia's new ultimate weapon: parliament.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Kidnapping in the Philippines

No more ransoms

May 31st 2001 | MANILA
From The Economist print edition

President Arroyo takes a tough line

JUST when President Gloria Arroyo was looking forward to a spell of relative peace and quiet in which to concentrate on reinvigorating the Philippines' sluggish economy, kidnappers from the notorious Abu Sayyaf group struck again. On May 27th they abducted 20 people, including three Americans, from a holiday resort on the western island of Palawan. Although the hostage-takers made no immediate demands, the government suspects that they simply want money. It dismisses the Abu Sayyaf's assertion that it is fighting for independence for the Muslim minority in this predominantly Christian country.

Mrs Arroyo ruled out either negotiations or a ransom. She warned the kidnappers to free their hostages unconditionally and surrender, or die in a hail of bullets. The Abu Sayyaf threatened to kill their hostages if the armed forces attacked. Days after the kidnapping, however, the army was still searching for the captors and their victims.

Mrs Arroyo's aggressive approach is clearly intended to correct the policy of her predecessor, Joseph Estrada, in handling the Abu Sayyaf's kidnapping spree last year. Millions of dollars were paid to the guerrillas in exchange for the freedom of some of the dozens of Filipino and foreign hostages the group had taken. But Mrs Arroyo's decision to adopt the military option is risky. While stressing that the safety of the hostages was the priority, a military spokesman admitted there could be casualties.

The abductions are sure to do further damage to the tourism industry, already battered by last year's kidnappings. And they are another distraction for Mrs Arroyo in her efforts to repair the damage done to the economy by the resurgence of corruption and crony capitalism under Mr Estrada.

Mr Estrada was deposed in January by a peaceful, popular uprising. But political violence erupted this month when thousands of Mr Estrada's supporters attempted, unsuccessfully, to storm the presidential palace. In the subsequent elections to Congress Mrs Arroyo's governing coalition appears to have failed to win the outright control necessary to push through her programme of economic reform. The last thing the president needs now is further growth in the kidnapping industry.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Crime and punishment in China

Bang, you're dead

May 31st 2001 | BEIJING
From The Economist print edition

A rising tide of executions

CHINA is in the grip of one of its periodic "Strike Hard" campaigns, the official slogan for an attempt to curb rapidly rising crime through the extra-enthusiastic use of capital punishment. Among those executed this week were Jin Jianpei, a former official in Hong Kong accused of embezzling millions of dollars, Cao Yufei, a Taiwanese businessman implicated in a huge fraud case, and dozens of others.

In the past month, over 500 executions have been announced by the official media, two or three times as many as usual. The authorities, however, do not make public every case, probably because to do so would mean excessively gloomy reading.

It was President Jiang Zemin who launched the latest campaign early in April at a meeting in Beijing of public security officials. He threatened to punish officials in charge of places where crime was rampant. According to the state media, delegates agreed that public order was "not only a major social issue, but also a major political issue". They called for "conspicuous progress" in the fight against crime within the next two years.

The deadline is significant. In the next two years China will face serious tests of its political and social cohesion. The country will almost certainly join the World Trade Organisation, which in some parts of the country will throw even more people out of work. It will hold a crucial Communist Party Congress in late 2002 at which sweeping leadership changes will be unveiled. In the build-up to this meeting, dissidents and the discontented will step up their pressure on the party to tackle their grievances, increasing the need for a crackdown on what Mr Jiang calls the "people's democratic dictatorship".

Amnesty International says that, taking just officially publicised cases, over 40 people a week are sentenced to death in China and that the country executes more people every year than the rest of the world put together: more than 18,000 acknowledged deaths in the 1990s. But April's conference concluded that crime was rising, that offences such as bombing, murder, robbery, poisoning and the abduction of women and children were "rampant" and that some places were "rife" with criminal gangs. Not much to boast of after shooting so many people.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Climbing Mount Everest

No room at the top

May 31st 2001 | KATMANDU
From The Economist print edition

Congestion is causing dangers on the world's highest mountain

CROWD control could soon become a crucial skill for climbers on Mount Everest, as important as physical strength or watching the weather. In a single day last week, nearly 40 people reached the top of the world—a record. Reports sent by satellite telephone from base camp spoke of queues at precarious ridges and jostling as people passed each other in the final dash for the 8,848 metre (29,028 ft) summit.

More traditional mountaineers sneer at the circus atmosphere surrounding Everest in recent years, and there are warnings that the crowds are making the mountain more dangerous. Overcrowding has already taken its toll. In 1996, 14 died on the mountain when the members of several expeditions were trapped at high altitudes by sudden snowstorms. Bad weather in early May led to this year's gridlock on the summit ridge, but casualties, luckily, were light. Just four climbers died, including a Nepali Sherpa who had made 11 previous successful ascents.

Traditionalists are also worried about the growing tendency of expeditions to set records and achieve "firsts", rather than simply climb the mountain. This year's crop of summiteers included the oldest man, 64-year-old Sherman Bull from Connecticut, and the youngest: 16-year-old Temba Tsheri Sherpa of Nepal. An American with only one arm was on the mountain this year; an Indian with no legs also tried but to no avail. In the most spectacular feat, Erik Weihenmeyer, an American, became the first blind person to reach the top of the world. His fellow climbers stayed in front of him on the way up, describing the terrain and ringing bells.

Nepal views Mount Everest as something of a cash cow; the government charges expeditions a minimum of $70,000. That is probably why officials in Katmandu are pooh-poohing concerns about overcrowding and talking about even more climbers coming next year. But a celebration of the 48th anniversary of the first conquest of Everest, by Sir Edmund Hillary and Sherpa Tenzing Norgay, was cancelled after violent strikes, called by the Communist opposition. Returning climbers who thought their challenge was over had to walk from hotel to airport so they could fly home to the usual triumphal welcome. Tumultuous Nepali politics, it seems, could be just the crowd-control measure that Everest needs.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Income distribution in China

To each according to his abilities

May 31st 2001 | BEIJING
From The Economist print edition

Market reforms mean that China is becoming more unequal

AP

Not much to celebrate

"LET some people get rich first," was the famous instruction of Deng Xiaoping, as China struggled to throw off the shackles of Maoist egalitarianism. Yet the widening gap between rich and poor, and between urban and rural people, is worrying officials, who increasingly fear that it poses a threat to China's social stability.

A correspondent for the Communist Party mouthpiece, the *People's Daily*, broached the subject at a news conference given by China's prime minister, Zhu Rongji, in March. "The general public has voiced fairly strong complaints about income distribution," ventured the reporter, asking what Mr Zhu thought about the issue. In response, Mr Zhu admitted that, according to 1999 figures, China's Gini coefficient (which measures income inequality) was 0.39, "close to the internationally recognised danger level". This, he said was "not yet" a serious problem.

Some Chinese economists, however, believe that the "danger level" has already been passed, and that official statistics considerably understate the income gap. Their worries are plausible: clad in communist flannel for the past 50 years, China may find it harder to tolerate levels of inequality that would cause few problems in a country like the United States (whose Gini coefficient is about the same as Mr Zhu's figure) with a long tradition of social mobility. At any rate, there is no doubt that China is in the grip of widespread discontent. Rising crime and serious, if sporadic, protests are a sign that even though absolute poverty is declining, at least in the countryside, rising relative poverty is resented. And in the cities, absolute poverty is increasing as well.

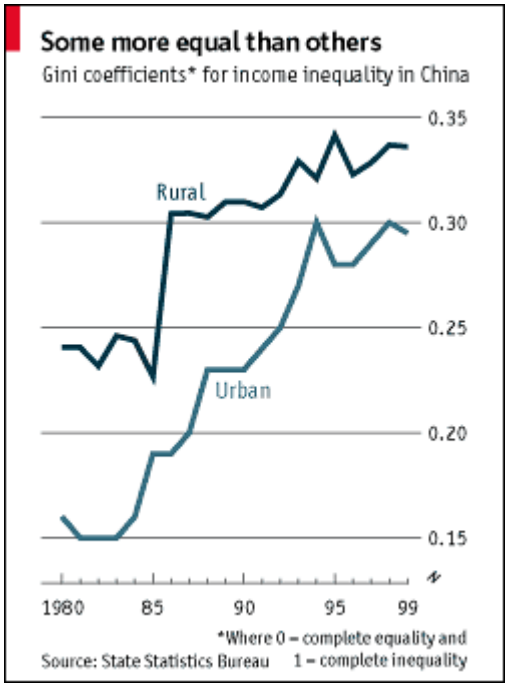
The Gini coefficient is a commonly used statistical gauge whereby nought represents perfect equality and one would mean that a single person received all the income (sometimes a scale of 1 to 100 is used instead). Chinese officials have tended in the past to accept that a figure over 0.4 should start ringing alarms.

Curiously, just a few days before Mr Zhu gave the figure of 0.39, Xinhua, the official news agency, said the figure stood at 0.458, "greater than the international warning line". He Qinglian, an economist who wrote a 1998 bestseller called "China's Pitfall" that looks at social disparities, believes the real figure is "way beyond" the one cited by Mr Zhu. Miss He says it could be close to 0.6. Official figures are unreliable, she says, because they fail to take into account illegal or undeclared earnings which often amount to a substantial proportion of incomes, particularly among the rich. Even using Mr Zhu's figure, China's income distribution is slightly more uneven than India's. If Miss He's figure is closer to the mark, it is among the world's most skewed.

Most Chinese, however, are less concerned with international comparisons or the national overview than they are with their own circumstances relative to their neighbours—in other words, keeping up with the Joneses. Here, even the sharply rising Gini coefficients provided by the State Statistics Bureau for rural and urban China (0.34 and 0.29 respectively in 1999, compared with 0.21 and 0.16 in 1978—see chart) do not fully capture the widely differing pace at which income distribution is changing in different urban areas and in different parts of the countryside.

When the economic reform era began in the late 1970s, urban residents enjoyed guaranteed jobs for life, free housing and health care. Unemployment was virtually non-existent and rural residents were banned from moving into urban areas. There was no private

enterprise. Most people's lives were spartan. But at least most people were not significantly worse off than their neighbours: and in those circumstances, as Tolstoy remarked, a man can endure almost anything.



By the mid-1990s, 9% of urban residents were living below the official poverty line of 1,800 yuan ($217) a year. But in some areas the proportion was much higher—30% in Xian, a city of 2.7m people, for example. And in some north-eastern cities that are home to many of the country's worst-performing state-owned industries, it was even worse, with 60% of Shuangyashan's 1.8m inhabitants living in poverty. Most of these people were forced into poverty by factory closures and lay-offs. Unemployment benefits, on the rare occasions when they were provided at all, barely sufficed to satisfy their basic food and clothing needs.

At the other end of the spectrum, Chinese economists reckon the country has about 3m yuan millionaires and over 1,000 yuan trillionaires. The richest 20% of urban households receive 42% of total urban income, whereas the poorest 20% receive only 6.5%. Such figures are pounced upon by diehard Maoists in China as evidence of how economic reform has gone badly wrong. The Maoists may have been marginalised politically in the past two decades, but their arguments—still vigorously expressed in a clutch of Beijing journals, make increasing sense to the many people in China who are on the losing side of reform.

After China joins the World Trade Organisation, officials expect inequalities to increase further, as hopelessly inefficient state-owned enterprises collapse and other companies benefit from improved access to world markets. Rural incomes will be further depressed by increased agricultural imports. According to official statistics, the average urban income was 1.7 times its rural counterpart in 1984. By 1999 it was 2.65 times. That gap will continue to widen, driving more country-dwellers into the cities and putting even greater pressure on the urban unemployed. Small wonder then if Chinese leaders are spooked by income disparities that are ominously similar to those that fuelled the revolution 50 years ago.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Nuclear power in Japan

A pox on MOX

May 31st 2001 | TOKYO
From The Economist print edition

Kariwa's voters rebel against a new fuel

THE Japanese never used to be this awkward. On May 27th the residents of the village of Kariwa on the Japan Sea coast voted in a referendum against the use of MOX, a new type of fuel, in the local nuclear power plant, the world's largest. The village's mayor put the project on hold, at a stroke imperilling Japan's multi-billion dollar plans to use plutonium in as many as 18 of the country's 51 nuclear reactors.

The residents of Kariwa were not the first to rebel against MOX, a mixture of plutonium and uranium oxides. In February Eisaku Sato, the governor of neighbouring Fukushima prefecture, said he would not allow its use in a local power plant, citing safety fears. A third project, in Fukui prefecture, has run into the sand after revelations in 1999 that workers at British Nuclear Fuels, which made the MOX fuel rods, had bypassed inspection procedures and falsified data on batches of fuel bound for the Japanese plant.

Plutonium seduced Japan's central planners because, unlike conventional uranium fuel, it can be extracted from spent nuclear fuel, again and again. This "nuclear cycle" promised to reduce Japan's dependence on energy imports, notably oil from the Middle East. Besides using plutonium in MOX fuel—which can be used in ordinary nuclear reactors—Japan also clings to plans to introduce fast-breeder reactors, which run on a mixture of plutonium and highly-enriched uranium.

Both plutonium and highly-enriched uranium are much harder to handle safely than conventional uranium fuel. This problem has already caused several accidents, including a runaway chain reaction at a plant 100km (62 miles) north-east of Tokyo in 1999 that killed two people. The rest of the developed world has abandoned fast-breeder reactors and the sort of MOX programme that Japan is trying to introduce. But the Japanese government is still pouring tens of billions of dollars into its plutonium programme.

Japan has so far sent its spent nuclear fuel to Europe, where 30 tonnes of separated plutonium are now awaiting shipment back home. Meanwhile, Japan has started building its own reprocessing plant, at a cost of ¥2.14 trillion ($18 billion). This plant will produce an extra five tonnes of plutonium a year when it opens in 2005. By that time, thanks to the European contracts, Japan will be sitting on more than 50 tonnes of plutonium, if its MOX programme remains stalled. That seems more and more likely because, along with the safety and proliferation worries, comes plutonium's appalling economics. Reprocessed plutonium is up to 3 1/2 times as expensive as conventional uranium fuel. This did not matter so long as Japan's ten regional power companies enjoyed local monopolies: customers would have had to foot the bill. But deregulation has already brought competition to the wholesale electricity market, and the retail market may follow. So the power companies have privately welcomed the public hostility to MOX fuel, promising not to introduce it against the wishes of local residents. Yet if they do abandon MOX, Japan will be left sitting on enough plutonium to make several hundred nuclear warheads. Partly for this reason, goes the government's curious logic, the use of MOX must proceed.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Russia's justice system

The path to reform—or another dead end?

May 31st 2001 | MOSCOW
From The Economist print edition

Soviet-style "justice" has gone, but Russia's courtrooms remain a shambles. Vladimir Putin wants to clean them up. A real advance—if it happens

ASK any Russian judge and he will tell you that with a leaky courtroom, an average of three criminal cases a day and a salary of around $100 a month, measuring justice is a luxury he has no time to indulge in. There are quotas to be reached. There are powerful prosecutors who telephone to say they would not appreciate losing a case. There is also the local governor who pays the court's electricity bills, so the judge would be wise to take that into account as well when handing out a sentence. Not to mention the sloppy investigators whose incompetence has to be covered up during the trial.

Luckily, if the judge bends a few rules along the way, the only ones to judge him are his fellow judges, so everything gets neatly hushed-up. The defence lawyers are powerless, and the accused...well, they hardly count, do they?

The days of show-trials, pre-scripted confessions like that of the engineer pictured above admitting to "treason" in 1930, and justice handed out in the courtyards of KGB prisons may be over, but Russia's legal system still has far to go. This, it seems, has caught the eye of President Vladimir Putin, who last week sent the Duma bills embodying his most ambitious project yet—a sweeping reform of the system.

The list of what is needed stretches endlessly. Russian courts are staffed by under-qualified judges who see themselves as governmental bureaucrats rather than an independent branch of the state. Prosecutors are lazy, brutal and accountable to no one—except perhaps politicians and officials. Poverty is pervasive, incompetence the norm, corruption rampant. And acquittal rates in a good year reach 1%.

Mr Putin wants to raise the judges' tiny salaries and pour money into the courts, most of which now smell and feel like public lavatories. This, he hopes, would end corruption and limit the influence of regional bosses. At the same time, the notoriously corporatist behaviour of the judiciary would be broken up by introducing outsiders—legal experts and law professors—into the bodies that rule on the appointment of judges or their dismissal.

Mr Putin also says he wants jury trials to be introduced throughout the country by the end of next year. Arrest and search warrants, he thinks, should be handed out by the courts, not the prosecutors. Defence lawyers would get more rights. At present, they are largely helpless observers of the bargaining between judge and prosecutor on the length of their client's sentence. To insist that he is innocent is a breach of courtroom ethics so serious that it can result in the accused getting a longer sentence just as a lesson in humility for his lawyer. The court can also refuse to question defence witnesses, or examine defence evidence. The new bills would at least force a judge to explain in writing any such refusal.

Prosecutors would have no right to start a criminal investigation against a lawyer. And their role in civil and commercial disputes would be drastically curbed—so much, say cynics, that without their wise guidance, judges might not know any more in whose favour to rule.

If they are passed, the bills could "help Russia show some symptoms of being a civilised country", according to Dmitry Kozak, a presidential aide widely seen as the man behind the reform. Many still wonder. Mr Putin did make the "dictatorship of the law" his catch-phrase, but people around him still have the disturbing tendency to apply the law selectively, and mostly against the president's political enemies. Cynics say it would be unwise of the president, by putting this right, to saw off the branch he is sitting on.

He may not have to. The bills now before the Duma hardly affect prosecutors' huge powers in criminal cases, which have long been mighty weapons in Russian rulers' battles against political opponents. Nowadays they do not get sent to gulags for anti-Soviet behaviour, but a charge of embezzlement can do the job.

What the reform could do is to change the lives of millions of ordinary Russians entangled in civil suits, which can run on for years as judges juggle 10-15 cases each day, or others accused of crimes such as robbery or violence; most of these are still committed in drunken squabbles or marital disputes. That on its own would be a real—and difficult—achievement. Similar ambitious plans once harboured by ex-President Boris Yeltsin were blocked by the stubborn obstruction of those who stood to lose, from incompetent judges to prosecutors afraid of having to work for their salaries. In the long term, the reforms might lay the ground on which, independently of anybody's plans, a new generation of responsible judges, lawyers and prosecutors could spring up. Who knows, justice may yet reach the courtroom.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Ukraine, Belarus and Moldova

A new misery curtain

May 31st 2001 | MINSK, CHISINAU, TIRASPOL, KIEV
From The Economist print edition

All three countries are in a bad state. The beneficiary, of a sort, will be Russia

Get article background

IT IS not a new iron curtain yet, but the dividing line looks increasingly solid all the same. Though democracy and the market have put down deep roots in much of ex-communist Europe, the three republics that once formed the western flank of the Soviet Union are plunging deeper into a spiral of authoritarianism and decay. After a decade of independence, this unhappy trio—Ukraine (population 50m), Belarus (10m) and Moldova (4.7m)—are a shambles. Russia is picking up the pieces.

There have been two big upheavals this year. One was a victory for the old guard in Moldova, the poorest country in Europe and now the only one ruled by unabashed Communists. The other came in Ukraine, after a long period of political ferment, and mounting protest against President Leonid Kuchma over the murder of a muck-raking journalist: the recent removal of the prime minister, Viktor Yushchenko, the three countries' only professed pro-western and reformist political leader.

The third country, Belarus, has long been on the wrong track. Since taking power in 1994, its erratic, high-handed leader, Alexander Lukashenka, has frozen ties with the West, shut down the press, suppressed opposition parties and created a heavily-controlled, lopsided economic system that pays wages less than a tenth of those in next-door Poland.

In the cold war, the iron curtain demarcated communism and Soviet hegemony. A different threat is posed by the new "misery curtain", caused by social breakdown and corrupt, incompetent governments: smuggling—often with the connivance of senior officials—of migrants, drugs, sex slaves and weapons, and the spread of organised crime and infectious diseases.

From bad to worse

A nasty outbreak of internal blood-letting occurred in **Moldova** in 1992. The Communist victory there has brought peace, of a sort, nearer. An ethnic Russian himself, the new president, Vladimir Voronin, has offered two large sops to the Russian-speaking separatists who have set up their own, self-proclaimed (and self-corrupted) state, Transdniestria, in the east of the country. He has proposed giving the Russian language official status in the whole republic, along with Romanian, the tongue of the majority. And he has suggested teaming Moldova up with the Russia-Belarus union, a ramshackle arrangement in which Russia trades energy for influence.

That link, he says, would reassure the Transdniestrian population that no future Moldovan government would seek union with Romania. The winding-up of Transdniestria would cause few tears except to its inventors. But there is little in Mr Voronin's economic programme to suggest that a reunited Moldova would live any better than a disunited one. After some hiccups, his bid for reconciliation with Transdniestria and its veteran strongman, Igor Smirnov, seems to be making progress. But his talk of snuggling up to Belarus suggests that Moldovans may soon be marching together in just the wrong direction.

If Moldova is a headache, **Ukraine** is a nightmare. It is the largest country in Eastern Europe outside Russia, and its success or failure affects the whole region. With Mr Yushchenko gone and the opposition

split, the Kremlin—and Russian big business—look set to be the biggest beneficiary of the change. President Vladimir Putin has named a Russian former prime minister, and gas magnate, Viktor Chernomyrdin, as his ambassador to Ukraine, with the task of "strengthening economic ties"—a mandate that sounds, to Ukrainian ears, like tightening the screws on a country already over-dependent on Russian oil and gas.

Taras Chornovil, a doughty opposition parliamentarian, calls the appointment a "full stop in Ukraine's economic independence". No one in Kiev minds Russian trade and investment as such; but the worry is that Kremlin-backed industrialists have been buying up Ukrainian industry on the cheap, with political influence part of the bargain. Mr Yushchenko's government had tried to stop this takeover. Now it can go ahead more easily. Mr Kuchma's choice as the new prime minister, Anatoly Kinakh, a loyal ally whose nomination narrowly squeaked through the parliament on May 29th, is best known as a business lobbyist. The issue will be whose business: though he promised further economic reform, the murky political climate is unattractive to westerners who might have given Russian investors a run for their money.

In **Belarus**, the loudly proclaimed love of Mr Lukashenka for his Slavic brothers in Moscow seems to have been spurned. The Kremlin looks as if it is preparing to support his rival in elections later this year, and it is also tightening the financial screws—apparently hoping for a new economic bargain that leaves Russia in control of its neighbour's lucrative potash industry and bits of the energy industry. In any event, Mr Putin seems to find his counterpart embarrassing and unreliable.

Russian influence

In another hint of Russia's resurgent influence, its largest political party, Unity, is surfacing in various parts of the ex-Soviet periphery—not least in Transdniestria, where its slick advertising and well-financed, well-equipped and well-guarded offices are undermining Mr Smirnov and his rival variety of pro-Russian loyalism. Unity is encouraging people in Transdniestria to take out Russian citizenship—an option that has also been touted in Georgia's pro-Russian statelets of Abkhazia and South Ossetia, other places where the legal government does not govern.

Is Russia's resurgent influence part of a consciously planned strategy, or merely an opportunistic bid to capitalise in various ways on the failure of its western neighbours to consolidate their statehood? Neither thesis can be proved or disproved. A cynical Ukrainian politician argues that there is no need to invoke dark Kremlin plots to explain his country's travails: "We are quite capable of committing national self-annihilation by ourselves."

Nor, at least until recently, has it been clear which forces in the three western republics' dramas were acting as stalking-horses for the Kremlin. In Moldova, neither President Voronin nor Mr Smirnov seems to enjoy unequivocal favour in the Kremlin, for all their pro-Russian talk. And in Belarus Mr Lukashenka's declared loyalty to Russia has plainly not been reciprocated.

What can be said, though, is that wherever Russia has had a choice between backing authoritarian forces and more democratic or market-oriented ones, it has usually opted for the former. In Belarus, for example, the Kremlin has shielded Mr Lukashenka, little as it may like him, from western protests about human rights. In Ukraine, it forced the sacking last year of an abrasively pro-western foreign minister, and Mr Putin vigorously defended President Kuchma during the wave of protests over the journalist's death.

Nor, whatever the uneven results of western aid in the region, is it likely that closer ties with Russia will make the affected countries any more prosperous. The places behind the misery curtain where Russian influence is strongest—Transdniestria and Belarus, notably—are also the most miserable.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Macedonia's ethnic fighting

On a knife-edge

May 31st 2001 | ARACINOVO, MACEDONIA
From The Economist print edition

NATO and the EU speak peace. Macedonians feel on the edge of war

Get article background

Reuters

Ethnic harmony up in smoke

IN DIPLOMATIC theory, the foreign ministers of the western world, meeting in Budapest, this week sent the divided people of Macedonia a clear and united message as to how their country can return to peace and inter-ethnic harmony. But in villages on the front line of what is all but the latest Balkan war, there is a palpable sense that things are on a knife-edge, with fighting as likely to spread as to die down.

At the first set-piece ministerial meeting between the European Union and NATO, Macedonia's government was assured of support for its statehood and promised that no one expected it to treat with Albanian gunmen. It was also told to be "proportionate" in its response to violence and take due regard for civilian life. The ministers called for a progress report, by the end of June, on a set of reforms designed to reassure Macedonia's ethnic Albanians.

Given that the EU and NATO, overlapping bodies that used to ignore one another, are now supposed to act as co-managers of Europe's security, it would have been an ominous sign if the two Brussels-based clubs had failed to send a clear signal. And mediation by Javier Solana, the EU's foreign-policy chief, was indeed crucial to the formation—and this week, to the rescue from disintegration—of Macedonia's multi-ethnic coalition.

But in Macedonia itself people see no ground for complacency. A military offensive, notionally in the name of the ruling coalition but in practice launched under pressure from the majority Slavs, has forced the National Liberation Army—self-appointed defenders of the ethnic Albanians—out of a couple of villages. But in fighting over recent days, the rebels have displayed impressive firepower. At one point they aimed at, and very nearly hit, a Macedonian barracks in the town of Kumanovo. That means they can strike anywhere in Skopje, the capital.

The rebels scored a propaganda success on May 22nd when they and the two Albanian parties in Macedonia's multi-ethnic government met in Kosovo and agreed on a peace plan, intended to upgrade the status of their community, which claims to account for at least a third of Macedonia's population. But the accord and the role played in it by Robert Frowick, an American diplomat working for the Organisation for Security and Co-operation in Europe, were instantly denounced by an embarrassed western world. And the Slavs' fury at the idea of their future being stitched up behind their backs was one reason for the intensity of the army's latest offensive, which went into high gear on May 24th.

Six days later, as the ministers of the western powers conferred in Budapest (and perhaps under pressure from them), Macedonia's President Boris Trajkovski floated a "partial demilitarisation" plan, including an amnesty for the rebels and the evacuation of thousands of civilians holed up in the town of Lipkovo.

Mr Trajkovski's room for manoeuvre is small, however. Last week's offensive was led by police units known as Tigers, and backed by poorly aimed artillery and tanks, plus helicopters piloted by Ukrainians. If the Tigers had not been sent in—or so the president was warned by hardline Slav Macedonians—then other feral creatures might have gone to work, including a group of toughs called the Lions who threatened to vent their wrath on ethnic Albanians in Skopje, the capital.

Whoever the winners are in all this, it is clear who the losers have been: civilians in the war zone. According to humanitarian workers, civilians in at least six Albanian villages—about 10,000 people in all—

have at various points been corralled by the rebels into sandbagged basements where they sat out up to three weeks of intermittent shelling, acting as imperfect shields. (Slav civilians suffered too; they have been forced to leave mixed villages.)

From the rebels' viewpoint, their human-shield tactics serve a double purpose: either the Macedonian government's forces feel obliged to restrain their fire, or they carry on with it and strengthen the rebels' moral case. In the end, it was the latter that happened, at least some of the time. According to Human Rights Watch, a New York-based watchdog, one civilian was killed, six wounded by mortar fire and seven people severely beaten during an attack on the tiny village of Runica; and Albanians have been beaten and tortured by police in Skopje and Kumanovo. And from such abuses, as Bosnians, Croats and Kosovars know, only too easily do mighty slaughters grow.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Charlemagne

Baltasar Garzon

May 31st 2001
From The Economist print edition

Spain's best-known investigating judge has enemies, of sundry sorts. Perhaps including himself

"WE ARE trying to limit the abuse of power, the manipulation of cases and the phenomenon of star magistrates... not mentioning any names," said a Socialist member of the cross-party team behind the wide reforms of Spain's legal system announced this week. The television producers needed no further cue. Up popped footage of a pepper-grey-haired, bespectacled man running up the stairs of a court building, bodyguards behind him. Nor did they need to mention names. Anyone in Spain can recognise its star investigating judge, Baltasar Garzon.

He tracks Colombian drug lords and Arab gun-runners, breaks up Basque terrorist units, pursues murderous Latin American brasshats, scrutinises Silvio Berlusconi's involvement in the Spanish media. In the early 1990s he went briefly into politics, saying he would fight corruption from the inside; a foray that ended in bitter attacks on Felipe Gonzalez, the Socialist prime minister who had recruited him. No wonder Mr Garzon is alternately praised as a champion of justice and denounced as a publicity-obsessed hijacker of the law. Pedro Ramirez, the editor of *El Mundo*, a newspaper that has often teamed up with Mr Garzon, calls him "infantile in his megalomania", but also acknowledges his "indisputable record in serving the rule of law". "The only magistrate who refuses to let the grass grow under his feet," says Pilar Urbano, the author of an adulatory biography published last November and now in its 12th printing.

Its hero was born in 1955 in a poor agricultural area of the south, to a peasant family of seven children. But their land would not support the growing family, and his father went to work at a petrol station in a nearby town, and then to the city of Seville. To give him a good education, Baltasar was enrolled in a seminary school and destined for the priesthood. But at 13, he failed a maths exam, and was sent to a crammer's. There, teachers were immersed in the 1968 French student revolts, discussing Sartre, listening to Leonard Cohen and criticising the church. The young Garzon underwent a long crisis of conscience. "I began to question principles that had been sacrosanct," he told Ms Urbano. "Besides, I was very attracted to women. I didn't feel capable of living in chastity. I didn't want to be a bad priest." He met his first girlfriend at 17. She was to become, and is, his wife.

Night shifts at his father's petrol pump helped him pay for university, and so to the tough competitive exams that led to the magistracy. His ideological turmoil continued—and still does. Mr Garzon wrestles with the remnants of his church education. In a country where few dare speak the word, he declares himself a republican. He has cosied up to and clashed with most groups that matter in Spanish society, and still managed to land on his feet. By chance or design? When, after brief stints in Andalusia and the Basque country, Mr Garzon got his post at the Audiencia Nacional, a court with nationwide jurisdiction and special powers against terrorism, drug-related and financial crimes, fellow magistrates christened him "the Prince", as in Machiavelli.

Hard work

What no one denies is his huge capacity for hard work, in a system better known for lethargy and bureaucracy. He thanks the long hours he spent studying law in a hot Seville attic, "learning to work in great discomfort and under high tension". Spaniards saw him doing so, on camera, as he tackled drug mafias in the north-west corner of Spain and investigated the death-squads that had operated against ETA, the Basque terrorist group, in Mr Gonzalez's day. For these, he pointed the finger at several ministers, two of whom went to jail, and even at Mr Gonzalez.

Mr Garzon's fervour can get the better of him. Last year the police spent days scouring a ship which he insisted was stuffed with drugs, and found nothing. His round-ups of alleged ETA collaborators, conducted in full view of the media, are apt to be followed by their swift release, because charges cannot

be made to stick. These round-ups have often followed suspiciously soon after much-publicised ETA attacks. Could it be that Mr Garzon was happy to help save the interior ministry's face?

Maybe: his attitude to the establishment is variable. In 1993 he stormed out of the Gonzalez government after being sidelined within the interior ministry, and flounced back into the Audiencia Nacional. His attacks on ETA and its support structure—closing a newspaper that acted as its mouthpiece, rounding up the entire leadership of its political wing, cutting off its sources of cash—have served Spain's current centre-right government well. But the case that made him an international name—the pursuit of General Augusto Pinochet—also gave that government a huge diplomatic headache.

To order the arrest of the former Chilean dictator while the general was on a visit to Britain was Mr Garzon's greatest media triumph. It also illustrated why he is so often in the limelight. Seekers of justice know he will not turn down a juicy case. Joan Garces, a lawyer who worked with Salvador Allende, the president whom General Pinochet overthrew, had been trying to nail the general for decades, without success. He sought out Mr Garzon, confident that he would take on the case—some of the Pinochet regime's victims were Spaniards—and push it hard. So he did, to the irritation of the Chilean government and to the deep embarrassment of the authorities in Spain and Britain.

Under the planned reforms, meant to make Spain's justice system quicker, cheaper, more effective and less malleable, magistrates' tenure in special courts like the Audiencia Nacional will be limited. May Mr Garzon's days be numbered? He has just had a close shave, when the Judiciary Council, the legal system's governing body, shelved an investigation into whether he had broken its code of conduct by giving details of cases to Ms Urbano. But even if the reforms, as eventually enacted, apply to him, they could take a decade to implement. He probably has little to fear, except murder (he gets lots of threats)—and himself.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

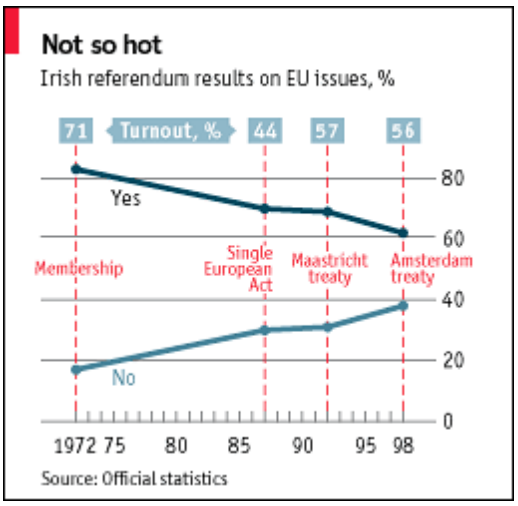
Ireland and the EU

Not quite so keen

May 31st 2001 | DUBLIN
From The Economist print edition

A referendum may reveal shrinking public enthusiasm for the EU

EVERY second lamp-post in Dublin seems to be festooned with advice about the referendum. “You will lose—power, money, freedom—Vote No to the Nice treaty”, cries one poster. Another insists that Nice is “Good for us, good for them—Vote Yes”. Yet Ireland’s voters seem baffled. A recent poll showed that only 11% claimed to have a good understanding of the issues. Baffled and underwhelmed: a low turnout is expected on June 7th.



Ireland is the only European Union country that will hold a referendum on the treaty that followed December’s summit in Nice. Its courts insist that any transfer of sovereignty must be approved by the people. That should present no problem, you might think: nearly 90% of them believe their country has benefited from EU membership, against the EU average of 47%.

The biggest political parties are all campaigning for a Yes. The No campaign, jeers Brian Cowen, the foreign minister, represents “the combined European wisdom of Sinn Fein [the IRA’s political arm], the Greens and the Socialist Workers’ Party”. Yet the Yes campaigners are still uneasy. Their margin of victory has narrowed in each successive EU referendum since the country joined the then EEC in 1973.

That trend could well continue. In previous campaigns, the EU has been portrayed as a cash-cow. Now, thanks to its new-found wealth, after 2006 Ireland will become a net contributor to the EU budget. The Irish also have less venal worries. Though the government portrays the treaty as a series of largely technical adjustments to allow the EU to expand, the No-sayers have seized on the efforts made at Nice to increase the voting weight of the bigger countries, and also to give the EU its own independent military capacity. Sinn Fein (yes, really) condemns the “militarism” of the treaty and its alleged threat to Ireland’s cherished tradition of neutrality.

Such concerns are beginning to resonate a little. Some usually pro-European newspapers and politicians have expressed reservations about the treaty on sovereignty grounds. Some see the rural vote turning against the EU, partly because of the prospect of a cut in farm subsidies. A recent rebuke from the European Commission over Irish economic policies went down badly across the country. But a Yes vote still seems far the likeliest outcome. And even if the voters do spring a surprise, the government seems unminded to take No for an answer. It has indicated that it would call a second referendum.

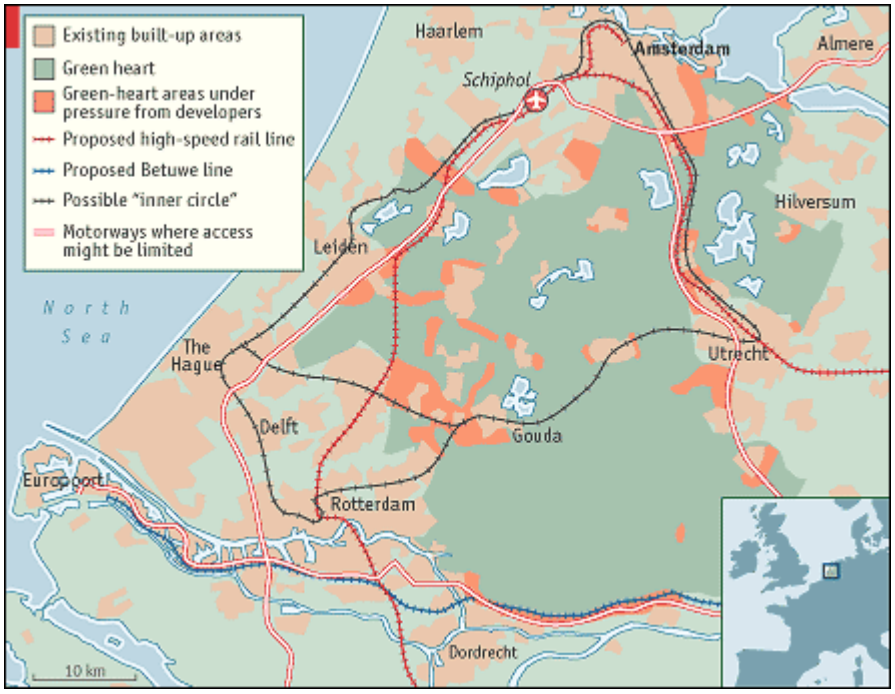
Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Planning the Netherlands

Europe's next metropolis, maybe

May 31st 2001
From The Economist print edition

That's what Dutch plans for an extra 2m people could lead to



THE Netherlands has 16m inhabitants. By 2030 it expects, thanks largely to immigration, to have 18m. Where are the extra bodies to go?

That is no new question for this crowded country: in the almost pre-pill 1960s, horrified planners expected 20m people by now. But it is still a big question, for all the new forecast's wide margins of error, and not one that the orderly (and Labour-led) Dutch, even in these free-market days, will leave to sort itself out. It is especially acute for the area called the Randstad, bounded roughly by Amsterdam, Utrecht, Rotterdam and The Hague. This area, even more crowded, with over 6m people, is the motor of the economy. Can the market be left free to keep it that way?

For decades, until the mid-1990s, official policy was to disperse the rising population across the country. It never worked: people and money go where people and money are. The new towns of Almere and Lelystad, on the last swathe of land reclaimed from the Ijsselmeer, are de facto satellites of Amsterdam. Yet it is still debatable whether to stop trying. Predictably, the environment ministry leans toward seeking to manage development, those of the economy and of finance toward letting the market have its way. (All, of course, within reason: these are the Dutch.)

Not that it is clear what the market wants. The Randstad cities have grown, but the big recent growth has been in smaller ones elsewhere, as in the electronics area round Eindhoven, home of Philips. Nor is the Randstad a unit. Amsterdam does well on Schiphol airport, tourism and finance; Utrecht on services (and nice surroundings). The Hague thrives on government. But Rotterdam lives off its port, the prime port of the Ruhr, 120km (75 miles) to the east. When German industry has suffered, so has it, and it still does.

A new metropolis

Hence an idea that has made rapid ground in the past two years: let's really treat the Randstad as a unit, not just a group of four large and sundry minor cities. Call it "Deltametropolis", no longer an overpopulated region but a single, thinly populated city, a conurbation to rival any in Europe. And the "green heart" of farmland and water in its midst? See that as its central park, an internal equivalent of London's "green belt".

The city councils concerned, happy to challenge the orthodoxy of dispersal, were swift to back this idea in 1998. The environment ministry has taken it up, in its latest 20-year look ahead at the shape of the Netherlands, issued in draft last winter and due for parliamentary approval this autumn. It may sound no more than a fun new name and a change of public image. In fact, far more is involved. The would-be "Deltametropolis" is the biggest land-use planning issue in Western Europe.

Green belts keep cities apart; a metropolis is joined-up—just what most planners seek to avoid. Can it be done without turning that central "park", already being nibbled away by the builders, into a central sprawl? No problem, say enthusiasts: restrain the building and improve the transport. Any part of the new metropolis should be within an hour of any other. Today it can easily take 90 minutes to drive from Rotterdam to Amsterdam, and even the efficient Dutch railways are creaking.

So? Well, double some rail tracks, and—besides planned long-distance high-speed rail lines—maybe build a high-speed "inner circle" round the Randstad. But rail alone cannot take the strain; that is a green fantasy. So improve the roads, while limiting motorway access, to deter local traffic. Improve bus services, and bring in high-frequency "taxis" (which, at European wages, is a Deltametropolitan fantasy).

In sum, murder the green heart, reply environmentalists. "Build a road or railway and the houses will follow," says one. And "central park" be damned. The land should be used, as it is now, for a mixture of recreation—not least watersports, on its many lakes and waterways—and (mainly) dairy farming, It should not, as the greens fear, become semi-urban space or be used for glasshouses, which earn far more and employ far more people than do cows.

There is also a peculiarly Dutch snag: water. Most of the green heart is peat bog, drained in past centuries, and still sinking, parts quite rapidly. More variable climate and the canalisation of small rivers has raised the risk of flooding in a wet winter. Plenty of space is needed (here the rivals agree) if flood is not to become disaster. How it is to be done and paid for no one is sure: where is the huge money needed to pay farmers whose land would be designated as real reservoirs or potential flood plains? But even were it practicable, here, to environmentalists, is another argument for leaving well alone in the green heart.

Yet is it well? Farming is under pressure already. The typical green-heart farm is a modest family business of 40-60 milking cows—and milk earns 15% less than two years ago. Yet land, even when not zoned for building, can sell for 100,000 guilders a hectare ($16,000 an acre), as pasture for some town-dweller's horses, maybe. Most farmers want to stay as such, and they have learned to earn by other means. Their war of 20 years ago with the environmentalists has recently become an alliance. They use fewer chemicals than before. Over half of all green-heart dairy farmers, via local co-operatives, are paid to conserve the environment. A meadow bird's nest, for instance, can earn 20 guilders, even 100 for a rare species. Yet the result is still a poor living. Change is inevitable: the planners guess that up to a fifth of the country's farmland may not be such by 2030, and the Randstad will lose its share.

It will get more than its share of the extra 950,000-1.9m houses that planners guess the country will need by 2030, and the 740,000-2.2m workplaces. Inevitably, say the builders: this is where people want to go. Yet the builders are cautious. They too are trying to make peace with the green movement—"extreme, but that's the way the public is going," says one. And the Deltametropolis idea? Yes, but. Builders too worry that the cities might run into each other: the customers for the up-market houses they want to build will want up-market surroundings.

Maybe, maybe

The debate—let alone future reality—is still open. Critics ask who needs a metropolis; hold down development in the Randstad, and encourage it in the nicer and emptier places even more in demand, to its south and east. Whatever the way ahead, officials reckon they can meet public fears, whether of sprawl or traffic gridlock. Use city space intensively; redevelop decayed industrial areas for multiple uses, housing included, which thins traffic; enforce zoning limits strictly, as often is not done now. Road-pricing and smart roads (eg, ones that can bring in extra lanes to meet peak demand, or control speeds

electronically) can raise capacity. So can smart train-control. If new links are needed, parts can go underground, like 9km of the proposed high-speed rail line across the green heart.

Maybe, but will the public believe it? Here is a country where plans for a new freight railway, the Betuwe line linking Rotterdam's Europoort with the Ruhr, aroused fierce controversy, even though much of the route runs alongside an existing motorway. Europe's new metropolis may well happen, in higgledy-piggledy fashion, anyway. But the issues are big, and not just for the Dutch.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Corruption in France

Dumas goes down

May 31st 2001 | PARIS
From The Economist print edition

Not for long in prison—but who will follow him?

Get article background

HOW are the mighty humbled. Little over a year ago Roland Dumas was president of the Constitutional Council, the highest court in France, and so nominally the fifth-highest person in the land. This week Mr Dumas, still cutting a debonair figure even at the age of 78, received a prison sentence of 30 months—albeit 24 of them suspended—and a fine of FFr1m ($130,000) for corruption involving the Elf oil company. That is a bruising fall from grace for a man who has been variously a Resistance fighter, a long-serving Socialist foreign minister, and a lawyer for Picasso, Chagall and Braque. As he said during his trial, "Running the risk of being dishonoured at my age is unbearable."

Still, there are lesser mortals to share Mr Dumas's pain—and worse. On May 30th a Paris court also sentenced Mr Dumas's former mistress, Christine Deviers-Joncour, to three years, half of it suspended, and a FFr1.5m fine; Loik Le Floch-Prigent, Elf's former chairman, to three-and-a-half years, and FFr2m; and Gilbert Miara, another lover of the generous Mrs Deviers-Joncour, to 18 months and FFr1m. Alfred Sirven, accused of directing Elf's network of bribery, was jailed for four years and fined FFr2m.

Of the seven accused who came to trial in January, after an inquiry that began in late 1997, only two—André Tarallo, formerly the managing director of the (then) state-owned oil company, and Jean-Claude Vauchez, a former director of an Elf subsidiary in Switzerland—were acquitted.

So is that the end of the "Elf affair"? Can the French public, by turns cynical and appalled, now take a break from the diet of political and financial scandal? No.

One reason for that is that Mr Dumas and the others found guilty have all decided to appeal. That means there may well be more tales to come of how Mrs Deviers-Joncour, the self-styled "whore of the republic", used a limitless Elf expense account in the late 1980s and early 1990s to provide Mr Dumas, at the time foreign minister under President François Mitterrand, with a chic apartment bought in her name, and to buy him valuable statuettes and a FFr11,000 pair of shoes.

Another reason is that Mr Sirven, extradited from the Philippines in February, may yet honour his threat to spill enough secrets to "topple the republic 20 times over". Mr Sirven is not a man to be easily cowed. As he was arrested, he nonchalantly chewed up and swallowed the memory chip of his mobile phone. Once in France, he refused to take part in his trial, on the ground that the judges had put off-limits an issue that he—far from alone—considered central to the case, the sale of some French frigates to Taiwan in 1991.

The allegation is that one state-owned company of the day, Thomson-CSF, asked another, Elf, to lobby Mr Dumas on its behalf, with Mrs Deviers-Joncour using her powers to blunt Mr Dumas's initial opposition. Mr Dumas says the sale was approved by President Mitterrand. What murky goings-on under that murky figure Mr Sirven might reveal, who knows.

There is a third reason: the "Elf affair" is not the only scandal in town. Even as the court was handing down its judgment on the retired Mr Dumas, two present-day Socialist politicians, Pierre Moscovici, minister for European affairs, and Claude Bartolone, minister for urban affairs, were being asked by France's newly-zealous investigating magistrates to testify about the past use of kickbacks on public-works contracts in the Paris region to finance political parties.

Meanwhile, Dominique Strauss-Kahn, the present government's highly-regarded finance minister until he fell foul of corruption allegations, was back in the news. The Paris prosecutors, it seems, wanted to investigate the suspicion that he reduced the tax bill of Karl Lagerfeld, a pony-tailed couturier, in return

for being given a video by Mr Lagerfeld's lawyer that implicated Jacques Chirac, France's president, in the political-financing scandal.

And there is more. Charles Pasqua, head of the centre-right Rally for France party, is being questioned on the state of his party's finances and—could they be linked?—on the sale of arms to Angola. Meanwhile, a maverick Socialist member of parliament, Arnaud Montebourg, is gathering his colleagues' signatures in a surely futile, but nonetheless headline-grabbing attempt to change the constitution so that a sitting president can be made to answer questions from the magistrates.

Mr Chirac was mayor of Paris for many years before he became president. But, as president, only if accused of treason can he be made to answer to the courts—as the Constitutional Council, headed by one Roland Dumas, once affirmed.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

General election

What's wrong with William Hague

May 31st 2001
From The Economist print edition

The Tories are facing another huge defeat, and William Hague may be facing the end of his political career

Get article background

Reuters

"THE problem for us is that we are simply not credible. Let's face it, we've had it," says a former Conservative cabinet minister. With less than a week to go to the election, and opinion polls pointing stubbornly to a second landslide defeat, the Tory faithful have begun to despair.

The Tories' defeat in 1997 was blamed largely on sleaze, Europe and the need for a change after 18 years. Since then, memories of the financial scandals that dogged the party have faded: the trial of Lord Archer, former party deputy chairman, for perjury, is the only hangover from that painful time. The arguments over Europe have not stopped, but they have abated. And the electorate has had the change of government it was begging for.

Yet the Tories have recovered no ground. Things look as bad as they did in 1997. Six months ago, most bets were on Labour winning with a sharply reduced majority of about 100, a loss of roughly 80 seats. By the time the election was called three weeks ago, Labour's likely lead, according to the spread-betting firm, IG Index, had increased to nearly 150. The hot money is now on an overall majority of around 200.

The opinion polls suggest a Labour lead of anything between 12 and 30 points. A poll by ICM, the Tory's own private polling company, published on May 30th, puts Labour's lead at 19 points, six points up on the previous week. If that lead were translated into seats on election day, it could give Labour an overall majority of 267, the biggest since Ramsay Macdonald's coalition government in 1931.

The reason, most observers agree, is not that Labour has won the campaign, but that the Tories have lost it. Part of the problem is organisational. The party which used to be known as a great election-winning machine is in tatters. Morale and membership are at a record low. The average age of its members is 62. But that is only a symptom of the Conservative Party's deeper problems.

The Tories were always going to have a tough fight because of the healthy economy. Vernon Bogdanor, an academic at Oxford University, says that the Tories are still dogged by Britain's humiliating expulsion from the European exchange-rate mechanism in 1992. It gained a reputation for being "the party of economic mismanagement" which it has not yet shaken off. But the conduct of the campaign has made things worse.

Enoch Powell once said that every party has to have "a theme to hum". The problem in this election is that the Tories have chosen the wrong tune. The anti-Europe theme doesn't set feet tapping. Voters aren't much interested in Europe. Even tax, traditionally a strong Tory issue, is lower in people's priorities than health and education, the areas that Labour has focused on.

Nor does the Tories' social conservatism play all that well. Vernon Bogdanor believes that they have failed to keep pace with changing public attitudes on issues such as drugs, asylum and race. "Hague's populism has gone down badly," he says. "Even if it reflects what people say in the bars, they don't want to vote for it. What they have is a ragbag of policies, some of them very nasty."

As Labour has moved on to the centre ground, so the Tories have abandoned it. That, according to Edward Heath, a former prime minister, is their mistake. "I think to win sufficient support to become the government again, they will have to broaden their whole approach," he has said.

It isn't just William Hague's policies that people dislike: it's the man himself. Not since Michael Foot, who led the Labour Party to its disastrous 1983 defeat, has a party leader been more unpopular. "A good management consultant but absolutely no sense of strategy," says a senior civil servant who worked closely with him in government. In a Gallup poll asking which leader had done the best job in presenting his party's policies, only one voter in six picked the Tory leader. Even among Conservative supporters, only 41% chose him. As Bob Worcester, boss of the polling firm MORI, puts it, "When Hague was chosen over Ken Clarke, the Tories did themselves in."

Focus groups hate the Tory leader's "flat, grating" Yorkshire voice and his "wally-like" appearance. Women are particularly vehement. "He's a tit," was one comment from a focus group conducted for the opposition. The Tories understandably are not disclosing their research. But the *Daily Telegraph*, usually a reliable supporter of the party and its leader, last week published the results of "a dial group". This is a method used by parties to test the public's reactions to politicians by asking them to turn a dial from positive to negative. The reactions to the Tory leader were "universally negative". Participants complained that they "couldn't stand his voice", that he was "not strong" and that he had not got "the right image" to be leader.

The decision that Mr Hague should be accompanied by his wife, Ffion, but that she should not be allowed to say anything is typical of the misjudgments made by the Tories' high command. The silent blonde is out of tune with the times; and the contrast with Cherie Blair's busy pursuit of her own career is painful.

Lord Blake, historian of the Conservative Party, takes a longer-term view. He believes the Labour tide was unstoppable at this election, that the Tory failure is little to do with the leadership and that criticism of William Hague is misplaced. Political parties that have undergone a traumatic election defeat invariably require at least two elections to recover, he points out. New Labour itself is a product of this political truth.

The Tories have reinvented themselves many times before, after similar catastrophes. The recipe has always been the same: a new leader, possessed of political and social imagination, has been able to re-unite a divided party around a new agenda, relevant to a new class or generation of voters. Robert Peel, Benjamin Disraeli and Stanley Baldwin all did it, as did Margaret Thatcher after the two defeats of 1974. Thoughtful Tories are now looking for another such (see article).

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Campaign diary

On the trail

May 31st 2001
From The Economist print edition

Insult of the week

EPA

An electoral convention dictates that politicians insist they want to discuss policy, whilst launching personal attacks on their opponents. Thus it proved when Labour unveiled a poster depicting the face of William Hague wearing Lady Thatcher's hair—managing to impugn his independence while snidely alluding to his baldness. Mr Hague took it all with good humour: "It would be good to have all that hair," he said, "though I'm not sure about the earrings."

Surrender of the week

There is another quaint convention among politicians—other than Charles Kennedy, the fatalistic leader of the Liberal Democrats—whereby they are not supposed, in advance, to admit electoral defeat, however inevitable it seems. But two top Tories seem to have abandoned this convention. Bernard Jenkin, the transport spokesman, predicted that "when" [*sic*] Labour was back in government, it would put up fuel duties—then tried to argue that he had been seduced into pessimism by the media. Meanwhile Tim Yeo, the agriculture spokesman, admitted to placing a bet on the size of Labour's majority.

Lunatic of the week

The Church of the Militant Elvis is contesting the constituency of Brentwood and Ongar. Among the tenets of its faith is this vote-winning maxim: "It is easier for a hound dog to crawl through the letter box of a whorehouse than a bogus Christian to enter the kingdom of heaven."

Cultural reference of the week

"I'm thinking of writing a musical about Tony Blair. It would be called 'The Lying King'."

Sir Tim Rice, a Tory composer, on culture and politics

Optimist of the week (1)

"I don't anticipate a landslide, if we get one it'll be fine by me."

Michael Portillo, shadow chancellor, on his modest ambitions

Optimist of the week (2)

“People aren’t chasing the Tories down the garden path like last time.”

Mr Hague looks on the bright side

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Newspapers and voting

The weakest link

May 31st 2001
From The Economist print edition

Newspapers' views do not seem to affect readers' votes

"IT'S the *Sun* wot won it!" claimed Britain's most-read daily newspaper so memorably in 1992, after rooting for John Major's Tories and ridiculing Neil Kinnock's Labour Party. By 1997, the Tory gazette had become the house journal of the victorious Labour Party. So then, naturally, it was "the *Sun* wot swung it!" This time, the *Sun* is still squarely behind Labour, and so is a wider spread of papers than at any time since 1945. Does this help explain Labour's firm lead? Apparently not: research shows that newspapers have little impact on their readers' votes.

Glancing at the 1997 election, this seems improbable. The Labour landslide, ending 18 years of Tory rule, coincided with an astonishing lurch to the left by both the broadsheet and tabloid press. In 1992, 70% of the press, in terms of circulation, backed Mr Major's Tories, according to Peter Golding of Loughborough University. By the end of the 1997 campaign, no less than 60% of the press had jumped behind Tony Blair's party instead. In this election, says Mr Golding, perhaps two-thirds of the press is supporting Labour.

But what causes what? Strong recent Labour support in both the press and the polls could simply reflect the way editors like to back winners, and keep readers.

The defection of the *Sun* provides a chance to test the relationship. Pippa Norris, at Harvard University, led a study which examined surveys of readers' voting habits both before and after the switch. It concluded that not only did the *Sun*'s conversion have little impact on its readers' votes, but that there was "neither significant nor consistent evidence that any of the papers that switched their support away from the Conservatives brought their readers with them." Even in the long run, the link between newspapers' biases and their readers' voting habits appears weak. After 1945, when the readership of pro-Tory papers outnumbered that of pro-Labour ones by three to two, the press favoured the Conservatives at every poll until the desertion of 1997—and yet six Labour governments were elected.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

An Italian in Liverpool

In search of an election

May 31st 2001 | LIVERPOOL
From The Economist print edition

Beppe Severgnini, our Italy correspondent and a columnist for *Corriere della Sera*, finds some people quite enjoying the campaign, and some quite unaware of it

WHEN it opened in 1914, the Adelphi was one of the greatest hotels in the world. With solid marble walls, indoor swimming pool, full central heating in all rooms, it was Liverpool's arrival and departure point for passengers on the great liners to America. It was here that Harold Wilson—a local MP, and a predecessor of Tony Blair's—used to spend election nights. Room 101, apparently.

I spread the news, to little excitement. People are busy, around here, tonight. There is the graduation ball for Hope University, a convention of church-bell players and a Welsh football team that decided there was no point in waiting for the match in order to celebrate, so they sing and hug each other in the lobby. Not only are these people ignorant of Harold Wilson's sojourn in the hotel, but most seem oblivious to the fact that a general election is only days away.

Merseyside is solid Labour territory, mostly of the old kind. The last Tory MP, Anthony Steen, was elected in 1979, and founded Thatcher's, a tea-room where one could sit and eat apple pie under a portrait of the then-prime minister. "He would come to the house with a thunderous voice, asking for our vote. The children were terrified," recalls Fleur Packman, a retired teacher who has kind words for Jane Kennedy, the sitting Labour MP. But now it is all too quiet, Ms Packman complains. "I haven't seen nor heard anybody. I am waiting. If they want my vote, they'll have to come and get me, you know."

The last time I was in Liverpool, Derek Hatton's Trotskyite militants were running the city council in the 1980s. Mr Hatton, for all his faults (a vast selection indeed), inflamed Liverpudlians, who love a good argument. "Scouse are like Neapolitans. Great sense of humour, laid-back attitude, maybe not the hardest-working people in the world," says Alberto Bertali, an Italian who runs a big factory making household appliances, loves the city and wouldn't want to live anywhere else.

A real Neapolitan—Alfredo Oliva, an architect who moved to Liverpool "per amore" and now walks around camouflaged in an Italian flag as the cook of the Adelphi's pizzeria—disagrees. "Until today, I didn't even know there was an election coming up. In Naples, and all over Italy, people are at each other's throat, before a big vote. That's good. That's how you make up your mind."

Maybe people in this city have made up their minds already, and that's why they don't bother with politics. They prefer to walk around in the drizzle, pretending it is spring. Boys in bright red Liverpool FC jerseys; girls in what looks like their underwear, but turns out to be an evening dress. Their Labour MPs enjoy huge majorities. Jane Kennedy, in Liverpool Weavertree, has almost 20,000. Peter Kilfoyle, in inner-city Liverpool Walton (home of the two football clubs, Everton and Liverpool), 27,000. Louise Ellman, in Liverpool Riverside, which includes poor and volatile Toxteth, 22,000. Bob Wareing, in Liverpool West Derby, 26,000.

Stan Jones, the organiser for the local Labour Party, asks whom I would like to meet. I go for Ms Ellman and Mr Wareing. Ms Ellman is a nice lady with piercing green eyes, and no illusion. Her constituency has one of the lowest turnouts in the country. "Young people are not interested, they don't feel connected. Four out of five are not going to vote. Older people talk to me about their everyday problems. One lady told me: 'If you don't fix my shower, I won't vote for you'."

Next morning I drive to the Dovecot Labour Club in Bob Wareing's constituency. It looks like a police station in Northern Ireland. Same red bricks, same small windows; bigger gates, though, and more graffiti. It is the sort of place where, once in a century, you could meet Tony Blair holding a pint.

Wally Edwards, a former aide to Harold Wilson, is expecting me. He is happy to talk about his days in the navy, and his encounter with the future prime minister, in 1945, in the Shefton Arms pub. He tells me

he's got two daughters married to Italians, who live in Tuscany. "What do they think about Silvio Berlusconi becoming prime minister?" I ask. "Not happy," Wally says. "But I told them: 'Come on, girls. At least you had got a couple of nice hammers-and-sickles on your Italian ballot papers.' Some working-class element, I mean."

Mr Edwards says he "is not much of a Blairite". But he works for the common cause. This morning, he must brief a group of volunteers who are about to deliver leaflets in the area. They leave the Labour Club with a shoulder bag that says: "Taking the Lead in Europe". I ask them if Europe is a big issue, in this campaign. "No, it isn't. But the bags were left over from the European election."

I am assigned to a small commando group formed by a mother with two children, Amy and Zac, aged seven and four, who dash from row-house to row-house dropping leaflets through letter-boxes. Amy says, "I keep fit with Labour." I must do well, as Mr Edwards and three old-timers decide it is time for me to meet their MP.

While we drive, they are in a good mood. "You seem to enjoy putting leaflets into letter-boxes," I say. They laugh: "It is not so much putting ours in that we like. It is taking the Lib Dems' out. You know, sometimes they stick out." Good, I think. Four pensioners, two children. At least six people in Britain are having fun in this election campaign.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Riots

Shades of brown

May 31st 2001 | OLDHAM
From The Economist print edition

Islam and hopelessness are a dangerous combination

WHITE Britons are used to thinking of Asian immigrants as those nice industrious people who keep the corner shop and the local curry house. So it was a shock to see youths of Asian descent on the streets of Oldham in Lancashire from May 26th to 28th, hurling petrol bombs at pubs and the police. Over three nights of rioting, cars and shops were trashed, scores of people, including 15 policemen, were injured, and 49 people (two-thirds of them white) were arrested.

AP

The prospects for Oldham's Asian youth

The people who were out on the streets of Oldham last weekend are angry. They do not see themselves as the instigators of trouble, but as the victims of economic change, oppressed by white-dominated police and officialdom. They feel the media has failed to report their side of the story, and so they firebombed the offices of the *Oldham Chronicle*, thus rather undermining their argument.

Stereotyping Britons of Asian origin is as useful as lumping all whites together as European. Around half of Oldham's 30,000 Asians (who make up 14% of the borough's population) are of Pakistani origin, and about 12,000 originate from Bangladesh—two quite different cultures. The rioters were mainly Pakistani youths. Nearly all of these two groups are Muslim, while Oldham's 1,600 Indian-origin people are Hindu.

Class and wealth create further divisions. People of Indian origin tend to be fairly prosperous. Many are Sikhs, from the wealthy province of Punjab, or the families of businessmen thrown out of East Africa in the 1970s.

Pakistanis and Bangladeshis come from a very different class. Most were recruited by cotton mill-owners after 1945 to work poorly-paid night shifts. They settled in the cheapest and poorest parts of town. As the mill-owners' efforts to compete by using cheap labour failed in the 1970s, they were thrown out of work. Custom dictates that these immigrant families should send surplus cash back home. Few had built up any capital to enable them to move into different jobs or start businesses. Unemployment rates in parts of Glodwick, where the riots broke out, stand at 40%.

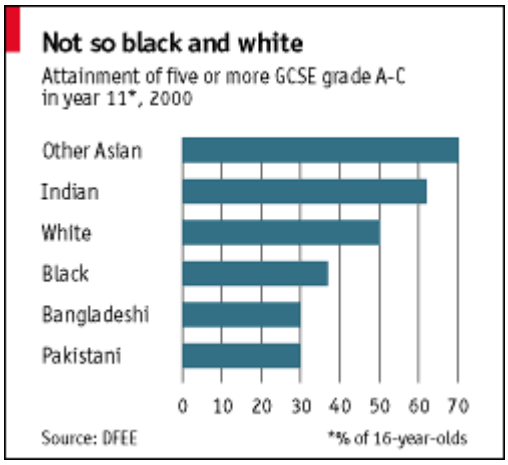
The council has tried to help these areas, securing government cash for housing regeneration and job-training schemes. But Phil Woolas, MP for Oldham East and Saddleworth, says that the whites believe that the Asians are getting a better deal, although just as much money is spent on white as on Asian areas. "Both sides believe they are victimised," he says.

Mr Woolas believes that right-wing agitators were also responsible for what happened. The British National Party (BNP) has candidates in all three of Oldham's parliamentary seats. While the BNP claims it is doing nothing more than exercising its democratic rights, police suspect local National Front types have been aided by reinforcements from outside Oldham, just as Asian militants have been coming in from places such as Bradford.

But even without the extremists, relations between Oldham's races are terrible. The Commission for Racial Equality (CRE) reckons that the town's ethnic communities are more starkly segregated than anywhere else in Britain. Divisions amongst the Asians look likely to make bridge-building perilously difficult. An oldish Asian man, watching police vans crawling along his street every 10 minutes, says the police are there to intimidate rather than protect. "If they had done their job properly and been fair to everybody, none of this would have happened," he says. But he refuses to give his name, fearing that Asian youths who don't want residents speaking to the media might threaten him.

Nothing in Oldham will get better unless the prospects for teenagers of Pakistani and Bangladeshi origin improve. Council statistics say that more than 40% of Asian-origin people are aged under 23. Their parents are poor, and often illiterate; and they, predictably, are at the bottom of the educational pile (see chart).

Schooling problems can be overcome, says Sir Herman Ouseley, a former chairman of the CRE who is compiling a report on Bradford, whose Asians have much the same background as Oldham's and where there was a similar riot in 1995. Exam pass-rates amongst Bangladeshis in the London borough of Tower Hamlets have improved markedly, he says, but it requires expensive and skilled teaching.



Part of the difficulty in Oldham and Bradford is that the Muslim youths have to cope with two different schooling systems—British state education, which teaches a questioning, assertive attitude, and Mosque schools, which their parents make them attend in their free time, and which teach total obedience to Islam. Together, the two systems produce questioning, assertive people driven by a strong sense of cultural identity and religious fervour. As Oldham has seen, it's a powerful combination.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Correction

May 31st 2001
From The Economist print edition

In our piece on self-help books on May 19th, we referred to Dorothy Rowe, a psychologist, as a psychiatrist. There is, she points out, a big difference: a psychiatrist can lock you up for the term of your natural life, but a psychologist can only ask you how you feel.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Opinion polls

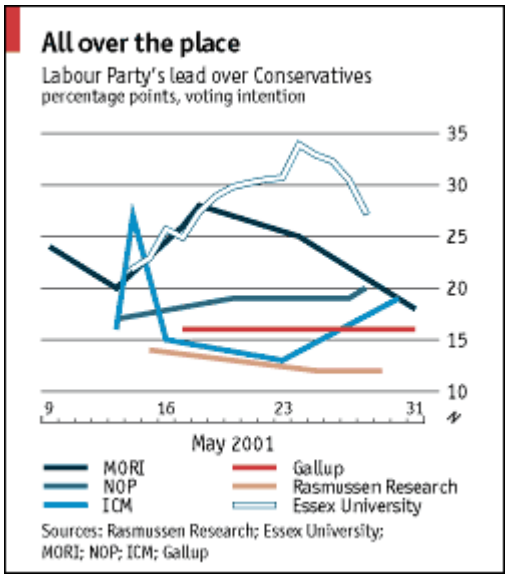
Differences of opinion

May 31st 2001
From The Economist print edition

The pollsters' results vary because they use different methods

DURING the first half of this campaign there was more disagreement among the pollsters than in any election since 1979. ICM consistently reported the lowest Labour lead (15%, on average), MORI the largest (25%), while Gallup (16%) and NOP (18%) sat between the two. There has been even greater divergence outside the established club. An American company, Rasmussen Research, has regularly put the lead lower than ICM, while a daily tracking study at Essex University has been reporting leads of over 30%.

This week ICM (19% lead) and MORI (18%) converged, but even so in a more closely-fought election their differences would by now have brought the industry into ridicule. And embarrassment is the last thing the industry needs. The pollsters did better in 1997 than in 1992, when they failed to anticipate the Conservatives' victory. But even in 1997, five of the six final polls overestimated Labour's strength.



The main reason for the differences lies in the different ways in which they have responded to the 1992 debacle. ICM, which has changed the most, switched from face-to-face to telephone polling. Telephone polling, which allows an interviewer to talk to Kingston one moment and Kirkwall the next, makes it easier to produce a completely random sample. What's more, some suspect that face-to-face polling may bias the result towards Labour, because richer, busier Tory voters tend to be out of the house more, and repeat phone calls are easier to make than repeat visits.

But both sampling methods have other weaknesses. Not everyone who is called will be in, let alone happy to be interviewed. And not everyone who is interviewed will say how they will vote.

ICM has tried to compensate through controversial weighting and adjustment procedures. First, the voting intentions of those who will not say how they would vote are estimated from their report of what they say they did last time around. Second, the sample is weighted according to what people say they did in 1997.

At first glance, weighting a sample in this way seems an obvious thing to do. After all, we know Labour won 44% of the vote in 1997, so if more people than that in a sample say that they voted Labour then it would seem likely that too many Labour supporters have been interviewed, and they should be "downweighted" accordingly. But voters are sometimes forgetful or embarrassed. Panel surveys, such as the British Election Panel Study, which interviews people immediately after an election and then again a few years later, get different answers the second time around.

But panel surveys provide a solution. They allow pollsters to adjust for faulty memories. Right now, the panel study shows that 6% more people say they voted Labour in 1997 than did so. So a representative sample of the electorate should include 50% who say they voted Labour in 1997. That is what ICM aims for.

Other pollsters have adopted some of these changes, but MORI has not. Although it does some telephone polling, its flagship polls for the *Times* are face to face, and it does not use weighting. The trouble with uncertainties, argues Bob Worcester, MORI's boss, is that they are uncertain. His polls report the uncertainties that ICM is trying to adjust for, but "our headline figure is a pure snapshot of voting

intention at a moment in time." June 7th—high noon—should decide the issue.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

The vote in London

City state

May 31st 2001
From The Economist print edition

In 1997, the Tories were routed in London. This time, it could be worse

OF THE many regional thrashings suffered by the Tories in 1997—the rout in the South West; the Celtic extermination—none was more dramatic than their humiliation in London. Michael Portillo's defeat in Enfield Southgate by Stephen Twigg, his amazed, smirking opponent, became an icon of Labour's landslide, though other London seats experienced even bigger swings. Yet on June 7th, the little patches of blue on the capital's electoral map could shrink even further.

AP

Portillo for breakfast

According to the polls, compared with 1997, the Conservatives will do especially badly in London. If they're right, the Tories could fail even to win back Kingston and Surbiton, the smug suburb that Ed Davey improbably won for the Liberal Democrats, with a gossamer majority of 56. Mr Davey, a brazen advocate of tactical voting, says he was "gobsmacked" to win in 1997, but is now "fairly confident". Worse, some Tories fear that they may even lose London seats; the most vulnerable is Chipping Barnet. Damien Welfare, the Labour candidate, hopes for a "Southgate effect".

Londoners have some powerful reasons for wanting revenge on the government: the acute recruitment problems in their public services; Tony Blair's clumsily autocratic efforts to stop Ken Livingstone becoming mayor; and the disruptive ruckus over the future of the Tube. The Tories have pledged to ban Tube strikes, two of which have been thoughtfully scheduled for election week. So why the exaggerated aversion to Mr Hague?

According to the most consoling explanation, it's the economy, William. Kingston and Enfield are exactly the sort of places whose residents are feeling good financially. Mr Twigg and Mr Welfare claim that more Tory voters are defecting to Labour, reassured about its economic competence. Commuting financial workers are also likelier than most to resent the forbidding Tory policy on the euro.

Another theory, advanced by Tony Travers of the London School of Economics, is that London and the Conservatives have evolved in different directions. Londoners are relatively easy-going about the sorts of social issues—drugs, immigration, family values—that exercise Conservatives. Both Steven Norris, the Tory candidate in London's mayoral election, and Rudolph Giuliani, the Republican mayor of New York, have been obliged to trim their parties' social policies for consumption by cosmopolitan, young and ethnic voters. London has traditionally been politically volatile, but according to this theory, its politics are increasingly distinct from the rest of the country's.

Perhaps it's only a theory: Danny Finkelstein, Mr Hague's chief policy adviser and candidate for Harrow West, says that fringe social subjects don't crop up on the doorsteps of "real people". Whatever the reason, the Tories could lose some of their last footholds in London, and therefore in Britain's inner cities. If that happens—and even with a leader representing Kensington and Chelsea—Conservative Party claims to speak for one, coherent nation will seem implausible.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Essex

Playing the hormone card

May 31st 2001 | BILLERICAY
From The Economist print edition

Picking the right candidate can be vital in volatile electoral areas such as Essex

ON JUNE 7th, attention will undoubtedly focus on Essex, not only because the BBC's chief psephologist, Tony King, is from Essex University, but because this is one of the most politically unstable parts of the country. It used to be Thatcher land. That famous journalistic construct, "Essex man", was the personification of the values of 1980s Toryism: working-class, aspirational, entrepreneurial and patriotic. Then in 1997, Labour picked off famous Tory seats, such as Basildon.

But Labour cannot afford to take anything for granted in this part of the country. In Essex, political loyalties do not run deep. All the candidates agree that Essex voters are an unsentimental lot. They judge parties by results.

They also like people who speak their minds, which helps explain Teresa Gorman, the retiring Conservative MP in the key marginal of Billericay. Ms Gorman is a forthright Eurosceptic, who became as famous for her espousal of hormone replacement therapy as for her views on tax harmonisation. Hormones also did for her predecessor, Harvey Proctor. Famous for his right-wing views on immigration, Mr Proctor's career was abruptly terminated by stories linking him with rent boys.

This time round, the Tories have played safe with John Baron. His hormones have produced children rather than political embarrassment, and he has impeccable careers in the army and the City behind him. He's the sort of chap who will stay resolutely on-message. In 1997, such was the feeling against Ms Gorman over her rebellions against John Major's government that a "Loyal Conservative" candidate polled over 3,000 votes. The swing against her was one of the biggest in the country and Mr Baron now defends a majority of just 1,356.

By contrast with the worthy Mr Baron, Labour has played the hormone card, choosing a self-declared Essex girl to win the seat. Amanda Campbell is Labour's Teresa Gorman. A journalist by profession, Ms Campbell is bright and breezy, with a refreshing tendency to canter off-message. Journalists must be rooting for a Campbell victory. No candidate from the New Labour clone factory will ever describe their blessed leader as "a cool geezer".

As Ms Campbell puts it, seats like Billericay are "up for grabs". Like many of the Essex constituencies, it contains both extremes of wealth, in Billericay itself, and of poverty, in the estates of Pitsea. The economy of Essex is also in a state of flux. The county has been hit hard by the loss of manufacturing jobs over the last four years, with Ford at Dagenham one of the biggest local casualties. But new jobs in sectors such as automotive research have, to some extent, compensated.

Billericay's new economy will no doubt have an impact on its politics. But no party is willing to predict precisely what that impact will be. For now, every vote will have to be earned on the doorstep, which is where Ms Campbell's local roots may come in handy.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Bagehot

Michael Portillo's moment

May 31st 2001
From The Economist print edition

He who hesitates laughs last?

"WHO dares wins!" declared Michael Portillo, the Conservatives' defence secretary, at the Conservatives' 1995 party conference. Back then, simply to hear the blood-curdling motto of the Special Air Service on those dangerous Spanish lips was enough of a thrill to make the good ladies of Conservatism totter to their feet and cheer him to the rafters. At a critical juncture, however, Mr Portillo did not dare. That same year, when John Major challenged his grumbling cabinet to back him or sack him, the daring Mr Portillo took soundings, counted friends, made preparations—and then held back. Mr Major limped on until 1997, when the voters put the Conservatives out of office and Mr Portillo out of Parliament.

The coming weeks should at last show whether that moment of hesitation was in fact the best thing to happen to him. There is a good case for thinking it was. Even if he had become prime minister, the Conservatives would still probably have lost the general election two years later. And after 1997 it was a positive boon for an ambitious Conservative to be out of Parliament. Most Tories guessed that whoever took over from Mr Major would face another election defeat and, afterwards, a probable leadership challenge. William Hague faces this prospect next week. Mr Portillo—back in the Commons as the member for Kensington and Chelsea, the safest Conservative seat in the land—must decide whether he can afford to blink again.

Mr Portillo's "friends" put it about that their man is no longer hungry for the top job. Such rumours are worth less than the paper they are not written on. Whoever grabs the crown from Mr Hague after June 7th stands a chance of becoming prime minister within the decade. If he had relinquished ambition, Mr Portillo would not have endured the double misery these past years of serving as shadow chancellor under the hapless Mr Hague while banging his head against the impenetrable complacency of the real chancellor, Gordon Brown.

Besides, Mr Portillo has all the advantages a pretender needs. First, he has been loyal, a virtue that is much admired by members of the Conservative Party even if it is seldom practised by their representatives in Parliament. Whenever challenged on his leadership ambitions, Mr Portillo has smiled his significant smile and replied, with no trace of irony, that there would be no leadership vacancy as Mr Hague would be prime minister. Second, loyalty has not stopped him allowing it to become known that if he had not deployed his good sense behind the scenes the party would look even less electable than it does now. Soon after Mr Hague made him shadow chancellor, Mr Portillo dumped the party's "guarantee" of perpetually lower taxes, and announced that Conservatives, too, supported a minimum wage and an independent Bank of England. Third, Mr Portillo has the charisma that Mr Hague lacks, and does not fear to show it. When still outside Parliament, he made a television programme in which he lured a guileless Mr Hague up a windswept mountain and asked him on camera a question that went something like: "Of course *I* know what a strong leader you are, William, but how come nobody else sees it?"

All these things argue strongly for Mr Portillo to seize his chance after the election, with a fair prospect of victory. Against this, he has two difficulties, still capable of combining to confound him. One is that Mr Portillo is not the same Portillo he was last time the Conservatives were in government. The other is that the Conservatives are not the same Conservatives.

My, how you've changed

Just before his adoption in 1999 by the Conservatives of Kensington and Chelsea, Mr Portillo disclosed that he had experimented as a young man with gay sex. This is a handicap. His party says it is broad-minded, and parts of it may be. But even Tories who could not care less about Mr Portillo's sexuality disapprove of the public display he has made of it.

Although Mr Portillo has never embellished his original confession, he has woven this part of his biography into a tedious narrative of personal self-discovery. Since 1997, the SAS-admiring Thatcherite attack-dog of yesteryear has evolved by careful degrees—self-publicised on television, in print and through speeches at party conferences—into the Conservatives' leading champion of personal tolerance and social inclusion. In finding himself, he claims also to have found out the secret defect of modern Conservatism: that it came to be unloved because it became untender.

That is not a bad account of what happened. If he could make himself believed, it would also be a good tale for Mr Portillo to tell the country about himself as he led the Conservatives back to the centre, from where they could ask voters for forgiveness and re-election. But here the second of Mr Portillo's problems arises. While he has changed in one direction, the Conservative Party has changed in the other. It is now even less liberal on social issues than it was under Mr Major. Lady Thatcher herself seems unimpressed by the fact that her former protégé remains as Eurosceptical as ever: she is said to find him "confused".

No longer trusted by those on the right; still resented by many on the left. If Mr Hague does not survive next week's defeat, Mr Portillo is by no means a shoo-in. The right is growing fonder of Iain Duncan-Smith, the party's defence spokesman, another Eurosceptic but unencumbered by Mr Portillo's complicated baggage or the battiness of Ann Widdecombe. But this simple soldier would be a far less adventurous leader for a party in desperate need of new ideas. Twice running now, the Conservatives have opted for second-best in order to keep out more talented leaders who have collected more enemies. Mr Portillo is the bookie's favourite. Although the ground is not yet as ready as he would like it to be, this time he had better strike.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Northern Ireland

Peace in danger

May 31st 2001 | BELFAST
From The Economist print edition

The result is likely to weaken David Trimble

WITH Labour heading for another landslide, the general election in Northern Ireland has attracted even less attention in mainland Britain than usual. But its result could rock the Good Friday power-sharing agreement. At worst, Tony Blair would then find that his most urgent task after the election was that of resurrecting the peace process.

The danger is a stinging rebuff at the polls for the Ulster Unionists (UUP), led by David Trimble. They could lose one of their nine seats at Westminster to a nationalist candidate and two or more seats to the Democratic Unionists (DUP), who opposed the peace agreement in 1998. Any greater loss than three seats might finally undermine David Trimble's authority as party leader and first minister in the power-sharing government.

That is certainly the dream of Ian Paisley. The leader of the DUP has form: he has succeeded in toppling previous leaders of the UUP. Now he is hoping for sizeable gains in the general election which will allow the DUP to seize the high ground in unionist politics.

At present, the DUP has three seats at Westminster, one of which was won from the Ulster Unionists in a by-election last year. Willie McCrea, who succeeded then in overturning a massive UUP majority, now looks set to retain this seat in South Antrim. In addition, Iris Robinson, the wife of the DUP's deputy leader, is favourite to win Strangford from the Ulster Unionists. Nigel Dodds, the able party secretary, is also likely to wrest North Belfast from the UUP.

Paradoxically, these losses may prove less painful to Mr Trimble than one might expect. In particular, he will not shed tears over the retirement of John Taylor, the deputy leader of the UUP and outgoing MP for Strangford. Mr Taylor has been an erratic supporter, giving more anxiety than reassurance.

At the same time, Mr Trimble could make an important gain. He is hoping that Sylvia Hermon, wife of the former RUC chief constable, will win North Down from Robert McCartney, the maverick UK Unionist. As a combative, articulate critic, Mr McCartney has caused Mr Trimble plenty of trouble. His defeat would more than compensate for the loss of North Belfast to the DUP.

On the other hand, a considerable section of the UUP would react with less *sangfroid* to election setbacks. If the DUP takes more than two UUP seats and the nationalists win one, Mr Trimble will be in trouble. His difficulties will be the greater if the local government elections, also being held on June 7th, dent the UUP's two-to-one lead over the DUP at district council level. A serious reverse could allow Mr. Trimble's critics within his party—Jeffrey Donaldson, Martin Smyth and Willie Ross—to mobilise against him.

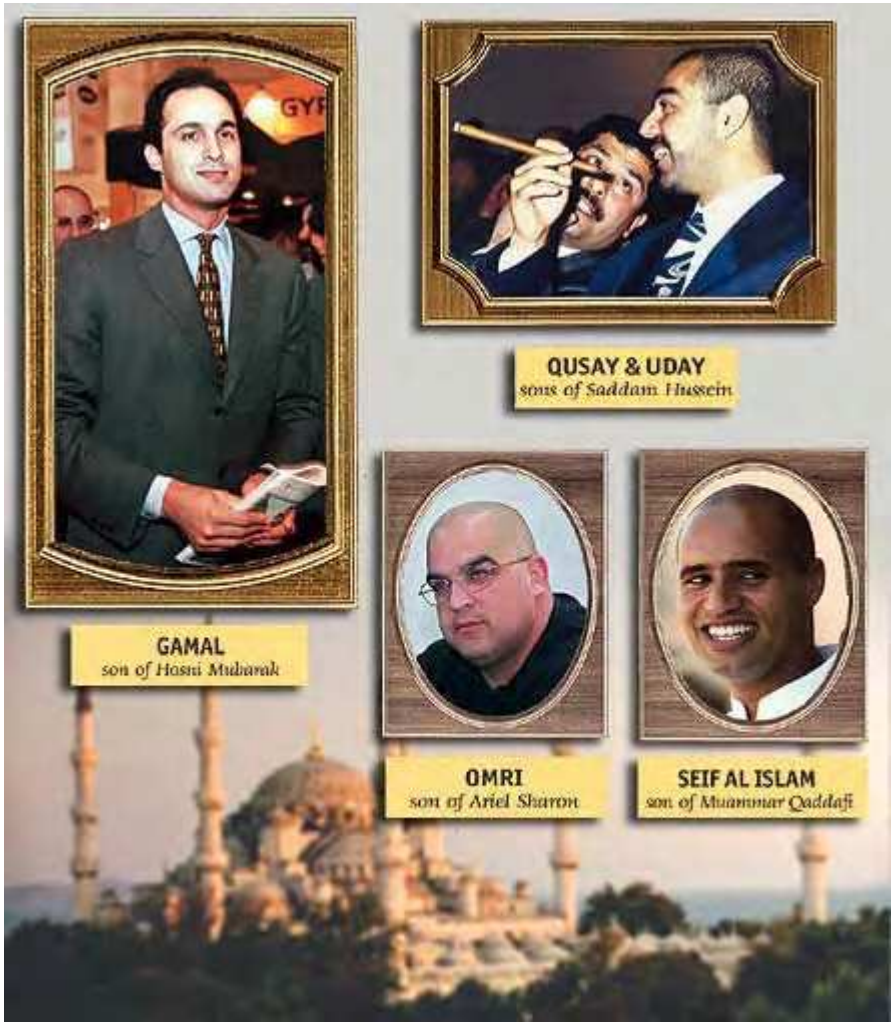
Despite this danger, the best bet is that Mr Trimble will be able to hang on. None of his rivals commands much credibility, not least because none of them can suggest a real alternative to the Good Friday agreement. But if Mr Trimble does survive as first minister, his authority is likely to be weakened.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Middle Eastern dynasties

Like father, like son

May 31st 2001 | CAIRO
From The Economist print edition



Monarchies, hereditary dictatorships and family nepotism in the Middle East

OMRI SHARON is just like his dad: big, blunt and controversial. His political emergence, first as a trusted adviser to Israel's prime minister, and lately as a backdoor conduit to Yasser Arafat, smacks to Israelis of creeping nepotism. Arabs wonder at such anxiety. With rare exceptions, their own nepotism is way past the creeping stage. The sons and other relations of rulers—whether kings, emirs or republican presidents—pack the corridors of power.

When Bashar Assad became Syria's president last year, after a quarter-century of his father's rule, the jokes flew thick and fast. "A sexually transmitted presidency," said some. Saadeddin Ibrahim, an Egyptian, was inspired to merge the Arabic words for republic (*gumhuriya*) and kingdom (*mamlaka*) into *gumlukiya*.

Mr Ibrahim, who was recently jailed by an Egyptian court for seven years, thinks the witticism may be one cause of his troubles. Egypt's president, Hosni Mubarak, has grown increasingly irritated by rumours that he, too, is grooming his son to succeed him. Although he flatly denies any presidential ambitions for Gamal, a businessman and junior member of Egypt's ruling party, the rumours do not go away. A typically irreverent Cairo joke has the president scolding courtiers who try to persuade him that hereditary rule is the regional fashion: "Egypt's traditions are thoroughly democratic. I will let the people choose between my two sons."

Egyptians have the luxury of laughing, but the people of Iraq recently had this choice made for them. President Saddam Hussein named his younger son, Qusay, as one of the two Baath Party figures with operational control over Iraq's armed forces. Since Qusay, aged 35, already controls the internal security services, the Republican Guard, and much of the lucrative oil-smuggling business, he is, in effect, already crown prince.

The only relief for Iraqis is that the choice did not fall to his flamboyant brother, Uday, who survived a hail of machinegun bullets five years ago. The older son still carries influence through his control of newspapers, television and the main Iraqi sports bodies. His critique of Iraq's performance at a recent Arab summit was enough to get the then-foreign minister demoted.

In fact, the Iraqi regime remains very much a family affair. Purges within Mr Hussein's clan have claimed several lives, including two of his sons-in-law, who were also cousins and senior officials. But the president's immediate relations and clansmen hold influential posts throughout the army, intelligence and party.

The same is true, though in subtler ways, in other Arab republics. Ahmed Abdullah Saleh, the son of Yemen's president, runs both the country's Republican Guard and an elite commando unit. Muammar Qaddafi's son heads Libya's football federation and a mysteriously well-endowed charity fund. He has also dabbled in diplomacy, helping to negotiate the release of hostages in the Philippines. Ties of blood or marriage link the richest businessmen in Tunisia and Syria to their leaders. Behind Lebanon's veneer of sophistication, half a dozen political dynasties still dominate the scene, doling out patronage and divvying up concessions.

Perhaps with more reason, nepotism is at least as entrenched in the region's monarchies. Royals traditionally occupy half the cabinet seats in most Gulf countries. An extreme example is Saudi Arabia, where the number of royal princes—around 7,000—is so large that they crowd out mere commoners from officialdom.

Such crowding makes the question of succession more complex than in simple dictatorships. The man who founded the kingdom in 1932, King Abdul Aziz ibn Saud, fostered at least 45 sons. Since his death in 1953, the throne has passed, in accordance with Islamic tradition, from the ablest or eldest of these brothers to the next. There are plenty of brothers left, including the current crown prince, Abdullah, who is expected to take over from the ailing King Fahd. These kings-in-waiting are in their 60s and 70s, and already troubled by rivalry. In the generation below are 150 senior princes.

Historians say that internal tensions created by the succession of brothers, rather than eldest sons, may account for the short-lived nature of many Muslim dynasties. The Ottoman Turks dealt with the problem by culling. When Sultan Mehmet III assumed the throne in 1595, for example, 19 of his brothers and cousins had been strangled to clear his path.

While one emirate, Bahrain, has dodged such pitfalls by enshrining primogeniture, some Middle Eastern monarchies have altered rules so that the reigning king simply appoints his successor. Such was the mechanism by which King Hussein of Jordan made his deathbed decision to pass the crown not to his brother Hassan, but to the present king, Abdullah.

Getting rid of father

Sultan Qaboos of Oman (who also carries the titles of prime minister, foreign, defence and finance minister, and commander of the armed forces) is childless, and has, unusually, set up a procedure to find a successor. Qaboos himself assumed the throne in 1970 by overthrowing his eccentric father. Similarly, the current emir of Qatar, Sheikh Hamad bin Khalifa al-Thani, ousted his own father in 1995.

Yet dynastic politics have functioned surprisingly smoothly most of the time. A majority of Arab nations remain fragile polities where loyalty is prized above ability, and the patriarchal family is the strongest state institution. In the case of Arab monarchies, this may be because no others have been allowed to develop; in republics, because other institutions have been systematically undermined.

Patriarchal rule has its advantages. Countries such as Jordan and Kuwait, whose borders are the product of imperialist cartography, draw a sense of identity from their royal families. The forward-looking rulers of Oman, Qatar and Bahrain have been able to push through radical reforms, precisely because their positions are respected. The United Arab Emirates, a federation of seven city-states, has smoothly

survived an explosion in wealth and population in the past 20 years, with each emirate still stamped by the character of its emir.

Family rule has even brought stability of a kind to Syria and Iraq, each of which endured decades of coups before succumbing to what appear to be hereditary dictatorships. But these regimes lack the legitimacy of 200-year-old dynasties. And it is not clear that Iraqis, after a quarter of a century of war and privation under Saddam, will accept his son.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Zimbabwe

Bad month for Mugabe

May 31st 2001 | HARARE
From The Economist print edition

A chain of events makes Zimbabwe's president look vulnerable

SUDDENLY, Robert Mugabe appears to have become both isolated and vulnerable. In the past month, Zimbabwe's president has been hit by the deaths of two senior cabinet ministers in separate car accidents, by harsh criticism from Colin Powell, the American secretary of state, and by rumours of a plotted coup. Although he will probably still run for re-election next April, it is beginning to seem unlikely that he will win.

Reuters

Death of a loyal ally

On May 26th Moven Mahachi, his defence minister, was killed in a road accident. He was one of Mr Mugabe's most loyal and trusted ministers, a staunch defender of Zimbabwe's involvement in Congo's war. Just four weeks earlier, Border Gezi, the employment minister, had also died in a car crash. Mr Gezi, a firebrand, was at the forefront of the recent invasions of white-owned farms. He also spearheaded the ruling ZANU-PF's violent campaigns in the parliamentary election a year ago, and had recently taken on the task of leading the campaign for next year's presidential election—a campaign that would rely on intimidation by the "war veterans", with whom Mr Gezi was closely associated.

The ruling party is split by factional rivalry, and many believe that the two deaths were not accidental at all, but the result of internecine plots. Be that as it may, they leave Mr Mugabe bereft of crucial allies. Another fervent supporter, Chenjerai "Hitler" Hunzvi, the leader of the war veterans, is in hospital after collapsing with cerebral malaria.

Mr Powell, on an official visit to Africa, has added to Mr Mugabe's woes by singling him out for criticism. Speaking in South Africa, America's secretary of state accused Mr Mugabe of using totalitarian methods, and of letting his "war veterans" terrorise the country. The economic and political turmoil caused by his determination to cling to power threatened South Africa's own prosperity and stability, said Mr Powell, and he urged South Africa's president, Thabo Mbeki, to put pressure on Mr Mugabe to allow free elections.

That was bad enough, but then reports of a planned coup emerged from South Africa. Senior South African officials told journalists that Zimbabwean army officers had informed them of a plan to oust Mr Mugabe if civil unrest erupted as a result of the food shortages that are expected later this year. Zimbabwean officials angrily dismissed the reports; the South African government denied them too.

Morgan Tsvangirai, leader of the opposition Movement for Democratic Change, remarked that a coup would not solve Zimbabwe's problems: only fair and open elections, free from violence, would begin to do that. Even with intimidation, his party is doing well, winning the election for mayor of Masvingo, despite a violent campaign by ZANU-PF in which war veterans forcibly closed all businesses and factories for a day to make sure that everybody attended a rally. This victory indicates that bullying is unlikely to win Mr Mugabe votes in urban areas. Rural voters are more vulnerable to threats and violence, but city voters account for about 40% of the country's electorate.

Mr Mugabe remains defiant. At Mr Mahachi's funeral this week, he vowed to continue expropriating land and any other foreign-owned resources to eradicate the legacy of British colonialism. But growing pressure, from inside and outside the country, may yet make an impression.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Congo

Daring to hope, again

May 31st 2001
From The Economist print edition

A UN delegation to central Africa found concession-making fashionable

Get article background

THE past suggests that when the warring parties talk peace in Congo, the world should fortify itself with heavy doses of scepticism. This week, however, peace in Congo did seem a few steps closer after a ten-day visit to the region by 12 ambassadors to the United Nations.

When a UN Security Council delegation visited the country a year ago, it came back empty-handed. Fighting continued. This time a similar mission has returned with commitments all round that look at least half-sincere. Congo's government lifted its ban on political parties. Uganda said it would pull its troops out of Congo except for those in a few areas near its border. The rebel group Uganda supports said it would disengage its frontline forces by June 1st. Zimbabwe has shifted from saying that its troops will begin to leave only after the Rwandans and Ugandans have gone, to saying that its last troops will leave only after the others have departed.

Evidence of faith in these moves was confirmed by the opening of the Congo river to traffic coming from the sea to Kisangani, a city deep in rebel territory. And all agreed that a "national dialogue" between the government and the armed and unarmed opposition would begin under the chairmanship of Botswana's ex-president, Ketumile Masire, on July 16th.

Last year's delegation, led by Richard Holbrooke, Bill Clinton's ambassador to the UN, mainly blamed Congo's president, Laurent Kabila, for the failure to implement the Lusaka agreement signed by all parties in 1999. Mr Holbrooke has now departed the UN, and the new American administration is uncertain of its African policy. Mr Kabila has departed this world, murdered in January. His son, Joseph, has taken over, and seems far more flexible and open-minded.

The Clinton administration tended to be sympathetic to Rwanda and Uganda, which had invaded Congo in 1996 to bring Kabila to power, and then again in 1998 to overthrow him. But, this time, the Americans left the leadership of the UN delegation to the French, who regard Congo as their lost fief, and are no friends of either Rwanda or Uganda.

Under the Lusaka agreement all foreign forces in Congo were treated the same, whether they had invaded (Rwanda and Uganda) or been invited by the government (Angola, Zimbabwe and Namibia). Now the "invaders" are being forced to get out first. The Lusaka agreement also said that the government and the rebels were to sit at a round table as equals. No longer: Mr Kabila will be president at the "national dialogue" and given special status.

The dangers ahead

Many pitfalls remain. One of the most dangerous is the Rwandan militiamen responsible for the 1994 genocide. They fled into Congo, and some now fight in Mr Kabila's army. Their presence was the stated reason why Rwanda and Uganda invaded Congo in 1998. They are unlikely to surrender their weapons: some are wanted by the UN's tribunal on Rwanda, others by the Rwandan government. Many of them may be quietly given Congolese citizenship—or go on to fight for the Burundian Hutu militias or even the Angolan rebel movement, UNITA.

The "national dialogue" will not be easy. The rebels will demand a political price for conceding the territory they now control. The unarmed, but probably more popular, opposition to Mr Kabila will have a hard time getting its voice heard. And the biggest unanswered question of all: who is going to rebuild a state that has been neglected for more than 30 years?

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

The Palestinian uprising

Arafat's studied non-interference

May 31st 2001 | RAMALLAH
From The Economist print edition

How much control does Yasser Arafat have over the intifada?

AS AMERICA'S new envoy to the region, William Burns, starts his search for ways to end the Palestinian-Israeli violence, killing remains the order of the day. Three car-bombs blew up in Israel this week, wounding several people, and three Jewish settlers were killed in the West Bank. Though Israel held back from large-scale retaliation, a Palestinian was killed in the West Bank, and two more in Gaza.

AP

Give me a reason to stop them

All this, said Israel's prime minister, Ariel Sharon, supports his insistence that the Mitchell Commission's recent call for an "unconditional cessation of hostilities" must precede any consideration of the commission's further recommendations, including a halt to settlement-building. To ram the point home, his government confirmed 700 new housing units in West Bank settlements, in addition to the 6,000 already under construction. The Palestinian leader is using the violence as an extension of his negotiating strategy, the Israelis claim, and could stop it any time he wants.

But Palestinians argue that Mr Arafat's control over the *intifada* is conditional on his moves being seen to further Palestinian national aspirations. If Mr Sharon were to commit himself to a settlement freeze, they say, Mr Arafat would commit the Palestinians to bringing the violence to an end. But since he is faced with an Israeli government committed to meeting none of the Palestinians' aspirations, and indeed provocatively challenging them, Mr Arafat has not so much lost control as temporarily relinquished it.

The trouble is that the longer the *intifada* continues, the more Mr Arafat's authority will diminish, personally and institutionally. Signs of this disintegration are everywhere. One is the latitude Hamas and Islamic Jihad bombers now enjoy, operating under the nose of the Palestinian Authority (PA). Another is the quiet emigration of members of his Fatah movement from their day-time jobs in the PA's security and intelligence forces to return to an older life as guerrilla fighters. They now work in bands called the Brigades of al-Aqsa in the West Bank, and the Popular Resistance Committees (PRC) in Gaza.

Can Mr Arafat put the genie back in the bottle? In late April he ordered the PRC to disband, and members to go back to their positions in the PA's security forces. Few did, and some declined by tendering their collective resignation. "With all respect," said one PRC leader, "we don't live under the PA. We live under Israeli occupation. And so long as the occupation continues, so will the Palestinian resistance."

Older Palestinian hands, who witnessed similar signs of anarchy during the resistance years in Lebanon and Jordan, insist that Mr Arafat's studied policy of non-interference should not be confused with loss of control. He still commands the loyalty of the 30,000-strong Palestinian police force, whose role has been largely dormant in the *intifada*. The police have the muscle to arrest the gunmen but, at present, they have neither the incentive nor a presidential order to do so.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

The plot thickens

May 31st 2001
From The Economist print edition

Ronald Grant

Ten years after the start of economic reform, India must decide whether to launch a second wave. There is plenty left to do, says Brooke Unger

YOU do not have to spend much time at the offices of Biocon, a biotechnology firm on the outskirts of Bangalore, to learn a thing or two about the state of India today. A few minutes inside is long enough to ascertain that Biocon is state-of-the-art, part of a high-tech boom that has appeared to lift India above the level of an impoverished third-world giant. Yet a glance at the frenetic construction site outside, hiving with human activity, tells you that although Biocon may be thriving, India remains poor. The rubble is shifted not by bulldozers but by the sari-clad women seen all over India who carry it in baskets on their heads.

A second glance, however, tells another story. In place of the customary coil of cloth on their heads, these rubble bearers are wearing yellow helmets, a rare precaution in a country that is normally unfussy about safety, especially that of the poor. And what stops the baskets from sliding down the smooth yellow domes? The sort of innovation that emerges from India's mish-mash of eras: each helmet is crowned with a little platform that will steady a rubble-filled basket.

How Indians interpret scenes like that at Biocon's building site matters to their future. If you ignore the helmets, you might conclude that India's decision, ten years ago this summer, to abandon economic planning and open up to global markets had enriched the privileged but left the poor as wretched as ever. This view is influential. One distinguished commentator, speaking probably for the bulk of India's intellectuals and do-gooders, called Bangalore's high-tech high-flyers "secessionist". People who share this view—or merely exploit it—have succeeded in slowing reform to a fitful stagger.

Exchange rates
May 18th 2001

$1=	46.9 rupees	€1=	41.2 rupees
¥100=	37.9 rupees	£1=	67.1 rupees

But the yellow hats imply that they are wrong. The forces pulling India into the global economy, they suggest, are also drawing poor Indians away from the margins and into jobs in which niceties like occupational safety matter. If that is so, politicians who obstruct reform in the name of the poor are repressing them as effectively as any landowner or loan shark.

If this were blindingly obvious, Indian democracy would dispose of leaders who block liberalisation and install a new set who promote it. But in India, where a river can be a goddess, a laundry and a toilet all at once, nothing is obvious. The country has states such as Gujarat and Maharashtra, which during the past ten years have been growing at the rate of Asian "tiger" economies in their better days; but it also has Bihar, with a population the size of Germany's and living standards on a par with Burundi's. Even within Gujarat, the "golden corridor" abuts some of the country's poorest areas. India can supply an example of any extreme, and convince you it is the whole story.

Seekers after economic truth usually turn to numbers, but even

India's statistics are less clear-cut than they might be. Recent figures showing that poverty fell sharply during the 1990s were celebrated by advocates of reform—and just as fiercely contested by its opponents. The country's official statistics are subject to frequent and unexpected revisions. India's variety and vagueness conspire to frustrate anyone who tries to be objective in charting the effects of economic reforms over the past decade. The place is all subplot and no plot.

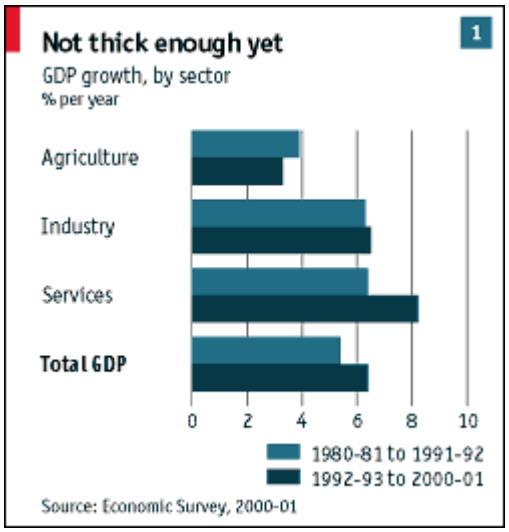
Reuters

The assertiveness training comes free

Happy ending?

This survey will attempt to trace an unfolding plot and script a happy ending. At first sight, economic reform may seem to have added yet another set of contradictions. In fact, it has launched India in the direction most Indians want to see it go: towards more widely shared prosperity and a position of influence in the world. The momentum is not irreversible, and the new direction raises its own problems: environmental, cultural and social, to name three sorts. These problems are grave, but none of them is an excuse for keeping a billion people poor. The bigger danger is that India will lose the plot by failing to push forward what it began back in 1991.

When it embarked on reform, the government of the day (formed by the Congress party, now in opposition) threw out 44 years of dogma. It abolished industrial licensing, which told entrepreneurs how much of a particular good they could manufacture and encouraged them to do it badly; it lowered trade barriers, which discouraged India from buying almost anything from or selling to the rest of the world; and it devalued the rupee.



On most measures, the reform was a triumphant success. Economic growth, after a brief wobble, picked up, making India one of the world's fastest-growing economies in the 1990s. Foreign direct investment rose from next to nothing to well over $2 billion a year (see table 2). India's share of world exports of goods, which had fallen from 2% at independence to 0.4% in 1980, climbed to 0.7% in 2000.

Having faced the prospect of default on its external debt in 1991, the country has now accumulated $40 billion of foreign-exchange reserves, enough to cover nine months' imports. Consumer-price inflation fell from 14% in 1991 to 4% last year. And a dynamic new export industry was born: software sales went from nowhere to an estimated $8.3 billion last year.

2 A tale of two giants

Economic and social indicators, 1999

	China	India
Foreign direct investment $bn	38.8	2.2
Share of world trade:		
*goods**	3.3	0.7
*services**	2.1	1.2
Population living on less than $1 a day, %	18.5	44.2
Illiteracy rate, adult population:		
male, %	9	32
female, %	25	56
Life expectancy, years	70	63

Source: World Bank *Exports + imports

Liberalisation transformed consumers from supplicants into customers. Any middle-class Indian has a tale about having to wait a decade or more for a car, or lugging back suitcases packed with forbidden goods from foreign trips. Since 1991 the number of serious car makers has jumped from three, making 190,000 old-fashioned vehicles, to ten, making 500,000, some of which would sell anywhere in the world. The number of daily flights between Delhi, India's political capital, and Mumbai, its commercial one, has gone up from three, on one slovenly state-owned airline, to 22, on three competing airlines (including the

former monopolist, which has improved its service).

Not only jet-setters have noticed. Liberalisation has made manufactured goods cheaper relative to farm products, making life a little easier for the farm sector, which still employs more than half the workforce. Manufacturers of consumer goods have discovered rural markets and flooded them with televisions and shampoo in one-rupee sachets.

Yet India's development is not merely an echo of reform. Agriculture, which accounts for a quarter of economic output, remains tied to the whims of the monsoon rains. The spread of television, to three-quarters of the urban population and a third of country dwellers, owes something to economic reform but also has a life of its own. Ask a manufacturer about the biggest influence on his business in the 1990s, and he is likely to mention television before de-licensing. Kirk Johnson, a sociologist who has studied the effect of its spread on two villages in Maharashtra, found that television not only spurred consumerism, but also made the poor more assertive and encouraged people to mingle more across the boundaries of caste, age and sex.

Unhappy anniversary

For all the successes of reform, India is beginning its second decade of economic freedom in a gloomy mood. Growth in fiscal 2000 dropped for the second year running, to an estimated 6.0%, depressed by a truant monsoon and an overhang of industrial capacity built in more buoyant times. A series of scandals—in defence procurement, share trading and customs collection—has temporarily paralysed the government and heightened ordinary Indians' contempt for the institutions that govern them. Indian farmers and industrialists have been spooked by the removal on April 1st of most of the remaining quantitative restrictions on imports, mainly on consumer goods and agricultural products. The only customer of the biggest private power plant, an early symbol of liberalisation, is having trouble paying its bills, and the main shareholder, Enron of Texas, is threatening to pull out.

These passing maladies point to deeper ills. There are grounds for questioning India's international competitiveness, the integrity of its institutions, the quality of its infrastructure and its zeal for further reform. India's growth since the original reforms were introduced ten years ago looks misshapen: agriculture is shrinking as a share of GDP, as expected, and services are growing rapidly, but industrial growth has been sluggish after an initial spurt. Jairam Ramesh, an independent-minded official of the Congress party, observes scathingly that "India is the only country in the world which has bypassed industry." That is partly because industry is especially vulnerable to the whims of the state. Services are fine, but they cannot create the millions of low- and mid-skilled jobs India needs.

Services are fine, but they cannot create the millions of low- and mid-skilled jobs India needs

Such worries show up in an investment rate well below what is needed to lift India's growth rate from respectable to spectacular. The appalling deficits of central and state governments have depressed public-sector investment. After a boom in 1994 and 1995, growth in private investment has slowed down. The government wants to quadruple foreign direct investment to $10 billion a year—and China gets $40 billion. The only other population billionaire is achieving growth in GDP and trade, and improvements in the quality of life, that India should envy and emulate (see table 2).

India's prime minister, Atal Behari Vajpayee, wants to speed up growth to 9%. That is the least he should be aiming for if India is to cope with an expected expansion of the labour force by 2% a year over the next decade. But it will be hard work. Shashanka Bhide of the National Council of Applied Economic Research in Delhi recently calculated that it would require agriculture to grow at an annual rate of 4.5% and non-agricultural sectors at an average of 10%. Even if annual growth in the productivity of land, labour and capital picks up to 3% (after being stuck in the 1990s at close to 2%, according to Mr Bhide), India will need to lift its investment rate from 25% of GDP to 38%. That means, in round figures, $40 billion in extra investment spending every year, including $5 billion from foreign investors.

As this survey will show, that is unlikely to happen unless the government adopts policies that rekindle the excitement of the early 1990s. And that, in turn, depends on India's leaders at last getting the message that reform is good for India, and ultimately good for them.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

The rich get richer

May 31st 2001
From The Economist print edition

But so, in smaller ways, do the poor

INDIA is defined by division. There is a divide between the economically dynamic south and west and the relatively stagnant north and east. Irrigated India remains lush during months when much of rain-dependent India turns barren. Urban India, unsurprisingly, is richer and more literate than rural India, where nearly three-quarters of the population lives.

The gravest charge against liberalisation is that it has deepened such divisions. That should come as no surprise. Inequality is bound to grow when the guiding principle for sharing out resources shifts from entitlement to competition. But even poor Indians have benefited from economic growth, and would be better off still if the economy grew faster.

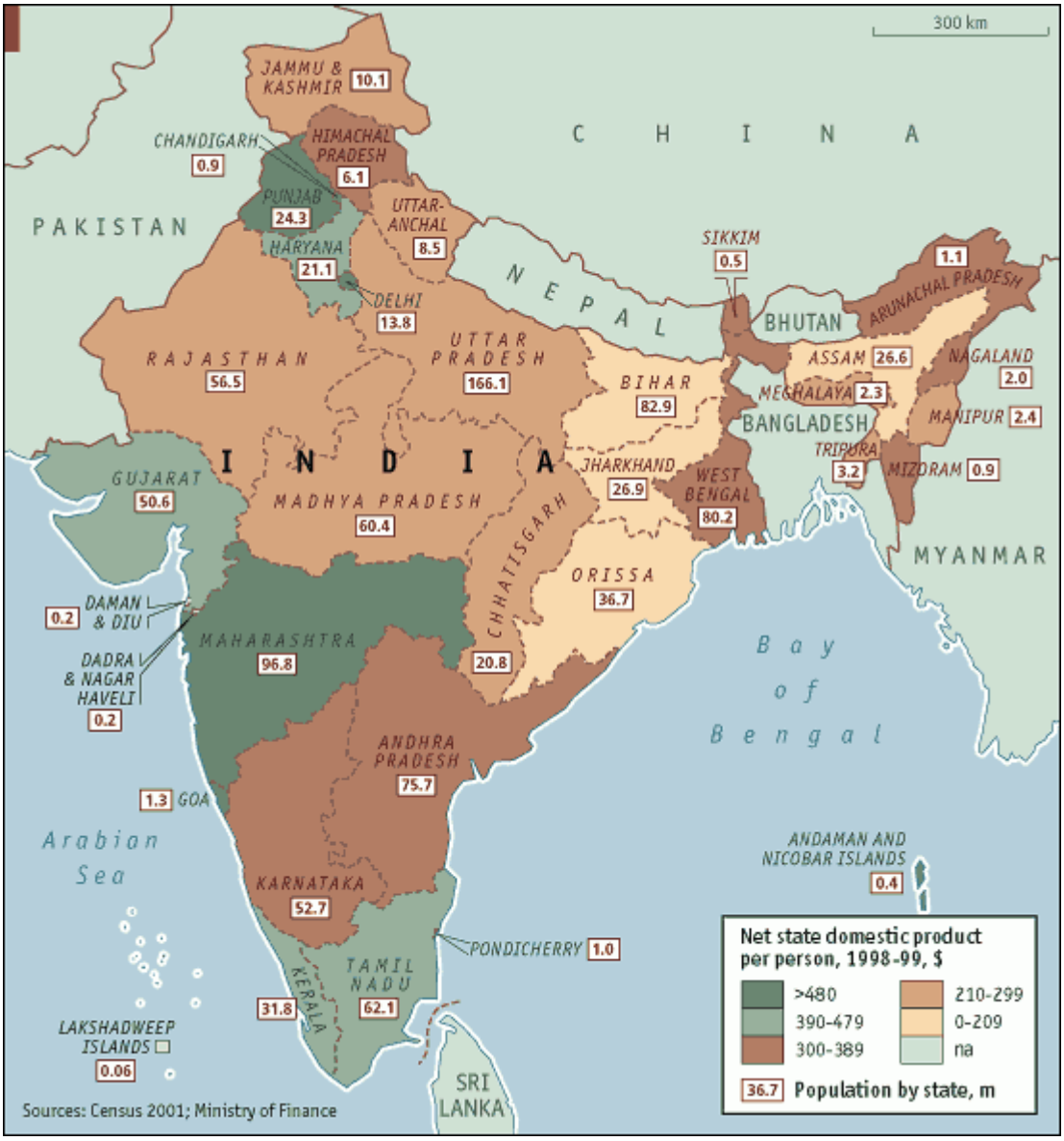
Most of the official figures back this up. The Planning Commission, which periodically calculates poverty rates for each state, recently announced that between 1993 and 1999 the share of the population below the poverty line plunged by ten percentage points to 26%, a faster decline than in the preceding ten years. Even in wretched Bihar the poverty rate fell dramatically, from 55% to 42%.

Best of the bunch 3

% of population

	Poor		Literate	
	1993	1999	1991	2001
Punjab	12	6	59	70
Haryana	25	9	56	69
Kerala	25	13	90	91
Gujarat	24	14	62	70
Rajasthan	27	15	39	61
Andhra Pradesh	22	16	44	61
Karnataka	33	20	56	67
Tamil Nadu	35	21	63	73
Maharashtra	37	25	65	77
West Bengal	36	27	58	69
Uttar Pradesh	41	31	41	57
Madhya Pradesh	43	37	45	64
Bihar	55	43	37	48
Orissa	49	47	49	64
India	36	26	52	65

Sources: Planning Commission; Census 2001



Other indicators too point to improved well-being. The National Council of Applied Economic Research, which surveys household incomes and spending on consumer goods, has found a sharp decline in implied poverty rates. The share of households it classes as “destitute” dropped from 23% in 1992 to 16% in 1998. And according to a recent employment report, real wages per head in 1993-99 rose by 2.5% a year in rural areas and by 2.7% in cities. The same report found that more people had left the workforce to attend school.

A triumphant vindication of reform? Unfortunately not. For a start, there has been a change in the way the survey on which the Planning Commission bases its estimates calculates poverty, so the scale of the improvement is open to argument. But more to the point, no one can declare victory when a quarter of the population still cannot afford to eat properly. Many Indians are still among the world’s most deprived people. And the good news on wages is spoilt somewhat by a rise in unemployment.

Although people in general seem to be better off, some regions have improved their lot much more than others. Gujarat and Maharashtra, two western states, notched up the fastest growth between 1991 and 1998, whereas growth rates in half the 14 biggest states actually declined. On a per-head basis the difference is even starker. Some states where growth is slow, including the two biggest, Uttar Pradesh and Bihar, also have fast-growing populations. In 1980 the number of poor people in these two states plus Orissa made up 38% of India’s total poor; by 1999 that share had risen to 46%. Looking at this regional slum, some people wonder whether India will hold together.

Looking at this regional slum, some people wonder whether India will hold together

Blame reform. When the government relinquished its power to dictate where factories should be built, investors picked the places where conditions were best. Montek Singh Ahluwalia, a member of the Planning Commission, has found that higher-growth states tend to have higher private (not public) investment.

He also found a link between growth and certain kinds of infrastructure, especially electricity and telecommunications, the subject of a later chapter. To no one's surprise, private investors chose advanced, outward-looking states such as Gujarat and Tamil Nadu rather than Bihar, which is so poor, badly governed and racked by inter-caste violence that Indians half-jokingly suggest it should be encouraged to secede.

But has Bihar really been left behind? Stroll around a Bihari village and marvel at the number of private schools named after obscure Christian saints. The schools may be for the village's more substantial citizens (tuition fees are about a dollar a month), and reflect a well-founded contempt for the education provided by the state, but they also suggest rising aspiration and attainment. A recent study of two villages in central Bihar, Bhokhila and Kaithi, suggests that even there the lot of the poor has improved.

The study's authors found the traditionally stratified social structure still in place, but not intact. Members of the lowest castes still live in ghettos away from the villages' bricked lanes. Few have land or livestock; their access to education and health care is "limited." In lean months, some resort to eating rats. Upper-caste folk have prospered, many of them moving away to become doctors and lawyers. The clear winners are those in the middle. They have leased or even bought the land of the absent elite, diversified away from rice and wheat, and begun to use tractors and pumps to irrigate their land.

The rising tide that lifts all boats

This has had an effect on the poor too. Mechanisation has driven some to migrate to richer Indian states in search of employment. They send money back to support their families in the villages. No one knows how big this "money-order economy" is; the remittances are not counted as part of Bihar's GDP. But it makes a difference. In Kaithi, the richer of the two villages, some poor households have followed the middle-caste example of taking over vacant farms. Most have abandoned their traditional caste occupations and bonds of patronage with upper castes.

This has not been a recipe for peaceful change: most of the grisly massacres of the state's caste wars have taken place in central Bihar. In Bhokhila low and middle castes have quarrelled over such issues as the control of land and the award of contracts for public works, conflicts echoed in clashes between radical-left and conservative parties. Yet one way or another, India's faster growth seems to have improved living standards even in these complicated little principalities. The study found "complete agreement...that the overall 'hunger' situation had improved."

Almost all poor people know that a greedy and meddlesome state is bad for them

Most of the citizens of Bhokhila and Kaithi are probably unaware of the 1991 reforms, as are 80% of India's total population. But almost all poor people know that a greedy and meddlesome state is bad for them. Lower-caste folk in Bhokhila complained bitterly about a cabal of middle castes and state officials who siphoned off resources from development projects. In Gujarat, the forest department monopolises the purchase of gum collected by poor women, supposedly to protect them from exploitation by middlemen. According to Renana Jhabvala of the Self-Employed Women's Association, a respected charity based in Gujarat, the monopoly made the gum trade legal, but also drove down by half the price women received for it. "When it comes to the poor you don't liberalise, you regulate," she complains. The head of one charity says that everything it does to help development in the countryside is illegal.

What the common folk do not know is that these hardships result from mismanagement and misplaced priorities on a gigantic scale. Populist schemes that pander to the poor generally backfire. Subsidised fares for train passengers, for example, drive up the cost of freight and move jobs out of the hinterland into easily accessible areas. As a result, power plants in the south of India find it cheaper to import coal from Australia than to buy it from Bihar.

The Planning Commission's account of various poverty alleviation schemes often reads like a criminal charge sheet. Writing of one rural development programme, the report cites "leakages, misappropriation of funds, violation of programme guidelines, selection of the non-poor as a target group, absence of proper maintenance of accounts and poor quality of assets". Such failings add up to colossal waste. Mr Ahluwalia calculated that last year 460 billion rupees in subsidies had been budgeted for largely ineffective schemes to help the poor. He suggested they be cut in half, and the money spent on infrastructure instead.

Clearly not all reforms help the poor. There will be pain as the government removes protection for

favoured industries to encourage industry in general. But a reformed state can soften the blow.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Red tape and blue sparks

May 31st 2001
From The Economist print edition

India's infrastructure—both the physical and the human kind—still leaves much to be desired

IF YOU withdraw 10,000 rupees from a bank, it will probably come in a brick of 100-rupee notes, held together by industrial-strength staples that you struggle to prise open. They are there to stop someone from surreptitiously removing a few notes. On trains, announcements may advise you to crush your empty mineral-water bottles lest someone refill them with tap water and sell them as new. You quickly get the message: be on your guard and trust only those you know.

AP

Worth investing in

Anyone doing business in India runs up against what might be called institutionalised friction. Whenever he ventures beyond an environment under his own control to one controlled by others, he needs to watch out. This happens every time he petitions a bureaucrat, signs a contract, goes to court or even turns a light switch. People are reluctant to do any of these things without safeguards. Contracts are written on the assumption that the buyer will not pay. Any sort of business that requires confidence in the judicial system is best left alone.

Trust can no longer be based on tradition

India has traditional ways of overcoming such obstacles. Much trade was, and still is, conducted within communities whose members are linked to each other by ties of kinship or caste. The country's $6.2 billion diamond trade, its biggest export earner, is largely in the hands of Palanpuri Jains from Gujarat. The illegal *hawala* market, a system for transferring billions of dollars mainly from Indians working in the Persian Gulf to their relatives at home, works smoothly. But in modern economies, which rely on bigger markets with new entrants and more fleeting relationships, trust can no longer be based on tradition. India is having to get used to doing business among strangers, and it is not finding it easy.

The shortcomings lie in two types of infrastructure: the traditional sort (roads, power grids, ports, telecommunications and so on), and what might be called the human kind (courts, the bureaucracy and politics). These are usually discussed separately, but would be better considered together, for several reasons. Failures in both have similar consequences: they raise costs, slow down transactions and deter investment. They also feed on each other. One reason it takes more than a week for a company in Mumbai to send a lorry to Nagpur, 750km (465 miles) away, and back again, is the poor quality of the road. The other is *octroi*, a local tax collected several times along the way, which goes mainly into the pockets of the collectors and their associates. India's power sector is a mess largely because people steal electricity with the connivance of the utilities. And raising the money needed to upgrade India's infrastructure will require good human infrastructure in the form of independent, incorruptible regulators.

Job-killers

You cannot measure Indian red tape, but evidence of it is everywhere. One director of a "new economy" company in Mumbai confides that he spends half his time with bureaucrats, who are generally looking for pay-offs. Naushad Forbes, director of Forbes Marshall, a manufacturer of steam engineering products in Pune, says it takes four days to get a finished product flown out of Mumbai, 170 miles away. He has lost orders to foreign competitors asking double his price but delivering in less than half the time. Vivek Jhangiani of Pleasantime Products, a Mumbai toy maker, says that excise officials can interrogate directors and staff "with no lawyers present".

Delhi's 200,000-250,000 bicycle-

The corner grocer must fend off municipal authorities, food and adulteration inspectors, the local police, telephone, sales tax and electricity departments,

and other “extortionists”, as R. Vaidyanathan, a finance professor at the Indian Institute of Management in Bangalore, puts it. Delhi’s 200,000-250,000 bicycle-rickshaw pullers collectively pay bribes of 20m-25m rupees a month for the privilege of being allowed to pursue their lucrative profession. A businessman in Mumbai puts “transaction costs” at 3-5%, compared with 0.5% in China, to which he is turning increasingly as a source of supply.

rickshaw pullers collectively pay bribes of 20m-25m rupees a month

Likewise, it is hard to measure the cost of a malfunctioning judiciary, but easy to identify some of the damage it does. India has too few judges—10 per 1m population, compared with 40-100 in developed countries—and a backlog of 27m cases. The only way to deal with a legal system that cannot be trusted is to be circumspect. Deepak Parekh, chairman of HDFC, a private institution whose main business is housing finance, says that in 22 years his company has not been able to foreclose once on a defaulting borrower. HDFC has few bad debts, but only because it is ultra-cautious. “If we had a better legal system, we would do more low-income lending,” he says.

Yet there are also heartening signs that some of the red tape is being cut. Scott Bayman, who has been running the Indian operation of GE, an American conglomerate, since the early days of liberalisation, says that the proportion of his time he spends in government offices has fallen from 70% to less than 5%. Anil Kumar V. Epur, former head of VST Natural Products (now called Global Green), a Hyderabad-based company that exports spices and condiments, has also noticed a huge improvement. Two years ago, customs officers insisted on checking the contents of every VST container themselves, holding it up for days. But a new system of self-certification has cut the time to get through customs by half and greatly reduced the “rents” the company has to pay.

Panos

Overdue for reform

Snap, crackle, pop

No sector needs reform more urgently than electricity, and nowhere is reform more difficult. The problem arises from its importance to India’s great game of political pass-the-parcel, in which politicians buy popularity with favours and hide the costs in cross-subsidies and higher interest rates. The state electricity boards (SEBs) buy and generate electricity and distribute it to a variety of consumers, some of whom, including farmers, get it for next to nothing. Others steal it, which the SEBs chalk up to “transmission and distribution losses”, averaging 30-40%. The SEBs pay for part of this by overcharging industrial and commercial customers. The rest comes from explicit subsidies or unpaid bills. The SEBs’ losses last year totalled 240 billion rupees, equivalent to over 1% of GDP.

The result is electricity of atrocious quality at astronomical prices for business, and a drain on the states’ funds. Because there is no money for investment, power shortages at peak hours are of the order of 13%. To escape blackouts and prices that rank among the world’s highest, many companies have set up their own power plants, which now account for nearly a third of electricity used by industry. Electricity reform “could add 1-2% to GDP almost instantly,” says R. K. Pachauri, director of the Tata Energy Research Institute in Delhi.

No sector needs reform more urgently than electricity, and nowhere is reform more difficult

India’s first stab at reforming the electricity sector, inviting in private firms to generate a lot more of the stuff, was laudable but misguided. Of eight “fast-track” agreements signed in 1993, three have yet to sort out their financing. The rest, and three “mega” power projects, have foundered on the SEBs’ inability to pay and other snags. Cogentrix of the United States, Electricité de France and Daewoo of South Korea have pulled out of Indian projects. The Dabhol Power Company, which has seen the biggest single foreign investment in India, was built with the aid of government guarantees and is generating electricity. But its sole customer, Maharashtra’s SEB, cannot pay its bills, so Dabhol (whose main owner is Enron, a big Texan company) has threatened to pull out of the project.

The road to reform is now well marked. Its essence is removing politics from power. The SEBs will be broken up into generation, transmission and distribution companies. Distribution is to be privatised, in the reasonable belief that profit-seeking owners will not tolerate theft and inefficiency. Tariffs are to be set by independent regulators. State governments will still be able to subsidise consumers, but the money will have to come out of their own strained budgets. So far, just one state, Orissa in the east, has

privatised distribution. Several others have handed over reponsibility for setting tariffs to a regulatory commission, but most chief ministers are worried about the political fallout of charging realistic prices for power.

Electricity reform was a centrepiece of the 2001 budget, presented in February. The states have been offered a variety of financial incentives for introducing reforms such as installing meters and letting regulators set prices. The biggest carrot would be to securitise the SEBs' 260 billion rupee ($5.5 billion) debt to the central government, but this plan has its sceptics.

Cellular telephony has gone from nothing to 3.7m users

A decent telecommunications system is within closer reach, for several reasons. Telecoms are the domain of the central government, not of the states; they are essential to the government's beloved information-technology industry; vested interests are less formidable; and telecoms customers can afford to pay. Already Indians are enjoying better service than before reforms. The state-owned monopolies have added seven times as many telephone lines in the past ten years as they had done in the previous 45. The cost of long-distance calls has fallen, though still not by enough. An unregulated cable-TV industry has wired up 33m houses. Cellular telephony has gone from nothing to 3.7m users.

Yet telecoms still demand vast investment. The government's plan to increase the proportion of people with access to a telephone from 3% to 15% could cost up to $70 billion, but at least some of the right conditions have been created to attract investment. Basic telephone services have been opened to competition, and private providers are already offering service in some areas. Long-distance services were freed in January 2000, and the state monopoly on international telephony is to end next April. Both the international service provider and the telephone company that serves Delhi and Mumbai, the two biggest cities, are to be privatised.

This has stirred up the private sector too. Reliance, India's biggest private-sector company, plans to hook up 115 cities with fibre-optic cable as part of a telecoms project costing $5 billion. Bharti, which offers cellular service in Delhi and basic service in Madhya Pradesh, hopes to link 27 cities. Bharti and others are planning undersea cables, which could turn the trickle of data that can now pass between India and the rest of the world into a torrent. Their bet is that India will be an outsourcing centre not just for software but for call centres and other back-office services that can be delivered by wire. "India wants to leverage its intellectual capital," says Anil Ambani, one of Reliance's two managing directors. "It needs world-class telecommunications infrastructure."

Yet Indian telecoms still lack what they most need to attract private interest: a regulatory system that investors trust. A decision by the Telecom Regulatory Authority of India (TRAI) to allow basic-service providers to offer customers limited mobility has pleased some investors but infuriated big cellular operators, who argue that companies offering mobile services ought to have mobile licences. This is the latest in a series of rows that have made some investors mistrustful of India's telecoms regulation. The government is eager for foreign investment, and recently lifted foreign-equity caps for certain services. But there is not much outside interest. "You've got to have trust in the regulator," says one senior manager in a multinational telecoms company. "We're in the dark."

The government has done India no favours by capping foreign investment in basic telecoms services at 49%. Its plan to keep a chunk of the two firms it is privatising has also put off some investors. According to Sunil Mittal, chief executive of Bharti, "India has missed the bus on foreign investment in the telecoms sector."

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Grim reapers

May 31st 2001
From The Economist print edition

If India's vast agricultural sector is to achieve its potential, the government must get off its back

IT ACCOUNTS for a quarter of the economy and 60% of the labour force. It produces so much food that government storehouses are overflowing with unsold grain, yet 250m-300m people do not have enough to eat. India's self-sufficiency in food is widey regarded as its greatest economic achievement since independence. Yet no industry is being as thoroughly hobbled by government intervention as agriculture. That is the biggest single reason for the persistence of poverty.

Panos

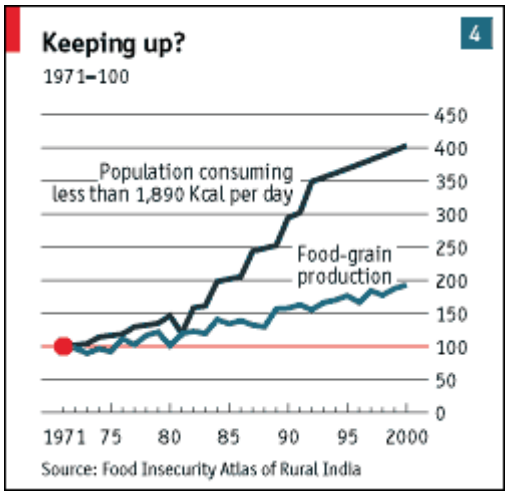
Try growing something else

Economists argue about whether agriculture has drifted or progressed since 1991. The official figures point to a slowdown. But Ashok Gulati, a scholar at the International Food Policy Research Institute in Washington, thinks they fail to reflect diversification away from food grains and into fruit and vegetables. He reckons that agricultural growth accelerated from 2.9% a year in the 1980s to 3.5% in 1991-99. Farming also benefited from falling prices for manufactures relative to agricultural products. In another sign that the countryside is maturing, the share of the workforce employed in agriculture dipped by four percentage points in 1993-99, to 60%, and in absolute numbers declined for the first time since independence.

But no one is satisfied. Just over a quarter of all farmers produce 60% of the total output. The rest are either subsistence farmers on plots of land that get tinier with each generation, or landless labourers. Agriculture has become a "parking space for the poor," as Mr Gulati puts it. The way out of poverty is faster agricultural growth, which would raise farmers' incomes and increase demand for locally produced goods and services, drawing labour away from farming. The government aims for an agricultural growth rate of 4.5%, but its policies seem tailor-made to prevent that.

The one thing the system does well is to encourage farmers in Punjab, Haryana and western Uttar Pradesh to produce enough rice and wheat to feed the country. It has been similarly successful in the dairy sector. These achievements are even more impressive than they look, for India does much to discourage the efficient storage, marketing, distribution and processing of food. Its aversion to the market has left a lot of people hungry. It has also stunted the development of a food industry. Value added in India is 15-20%, compared with over 100% in some developed countries.

The way India handles its main food crops is positively perverse. Farmers in the country's breadbasket are offered minimum support prices for wheat and rice which have been rising sharply over the past few years. The price subsidy, coupled with almost free electricity and water, has encouraged farmers in India's most productive regions to overplant water-guzzling rice; the area in Punjab under paddy has grown from 300,000 acres (120,000 hectares) in the 1960s to 6.5m today. Water tables in Punjab are dropping fast and the soil's fertility is at risk.



Yet the glut has not brought wheat and rice within reach of the poor. At the inflated minimum support price, the biggest buyer is a government-owned monopoly called the Food Corporation of India (FCI). As the farmers' favourite buyer, the FCI has accumulated some 45m tonnes of grain, twice as much as it needs for a reasonable buffer stock. The poor are entitled to buy some of this food at half the cost of purchasing, storing and distributing it, a subsidy that costs the government 130 billion rupees a year. They do not get their hands on much. A

third of the FCI's holdings are rotting in the open, and a third of wheat and rice meant for the poor is "diverted" from the public distribution system. After waste and corruption have taken their toll, the "economic cost" is 60% higher than the purchase price, making the food unaffordable for the poor. Other commodities are not treated with the same indulgence as wheat and rice, but they, too, suffer restrictions that erode their value to both farmers and consumers.

Shortcomings in infrastructure hit agriculture harder than any other industry. Farm produce lacks an adequate chain of refrigerated warehouses and transporters, and deteriorates on long and bumpy rides from farm to consumer. About 20% of total agricultural output, and 40% of fruit and vegetables, is lost along the way. A long chain of intermediaries further widens the gap between what consumers pay and what farmers receive.

A long chain of intermediaries widens the gap between what consumers pay and what farmers receive

Public investment in irrigation and other agricultural projects has been falling since the 1970s, partly because governments have preferred to spend money on self-defeating subsidies, such as for electricity and water. Private investment in irrigation has picked up much of the slack.

Stuck in the past

Rather than freeing its farmers, India has fetishised them. Early in its independent history, central and state governments broke the feudal order in the countryside by limiting the size of land holdings and transferring ownership of land to those who worked it. Land reform gave birth to a productive peasantry, the driving force behind the green revolution, but it is now thwarting consolidation of land holdings that have become too fragmented. In Uttar Pradesh, the biggest state, 20m farming families subsist on 17m acres of land. Even in Punjab, average holdings are too small to make mechanisation worthwhile. Farmers get around this, illegally, by leasing out their land and then working on it for a wage. But neither lessor nor lessee is willing to invest. This is one of the main reasons why India's rice and wheat yields are just a third of international levels.

The central government has begun to recognise that agriculture, like industry, needs the market. In his February budget, the finance minister, Yashwant Sinha, proposed cutting the number of goods covered by the Essential Commodities Act, which restricts trade in food, and shifting responsibility for buying food for the poor from the FCI to state governments. These proposals are meeting resistance from the states. If they went through, and state governments co-operated, India could operate as a single agricultural market, and the private sector could play a bigger part in buying and distributing grain.

Rather than freeing its farmers, India has fetishised them

Meanwhile, private firms are finding their own ways round the obstacles. Pepsi, an American food and soft-drink giant, is offering thousands of Punjabi farmers an alternative to pouring grain into official warehouses. It has reintroduced groundnut, a crop that consumes less water than rice and adds nutrients to the soil.

Organised retailing will also supply some of the missing market signals. Foodworld, a Chennai-based grocery chain, has cut out middlemen in the rice trade by buying direct from mills. In Tamil Nadu, it buys vegetables direct from 50 farmers and helps supply them with seeds, fertiliser and irrigation. Such initiatives will raise farmers' income, and growth in other sectors will help reduce their numbers.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

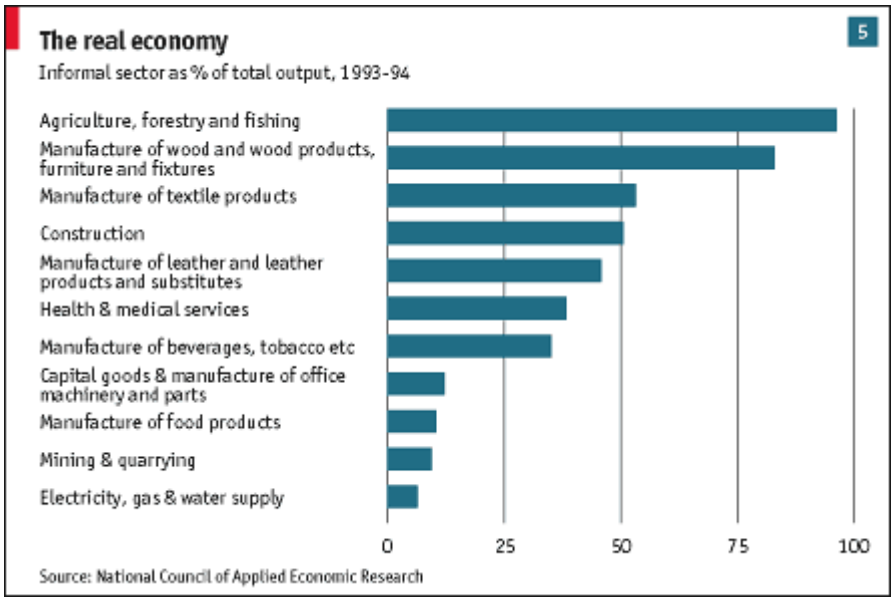
The unknown majority

May 31st 2001
From The Economist print edition

India's small firms are nimbler than the big ones—but more vulnerable too

JAGADEESAN INDUSTRIES, "manufacturers of precision auto components", may be small, but it is plugged in. Over the past five years, the three brothers who own it have put Japanese notions of total quality management to work in their tiny factory in Chennai. Machine operators have "ownership" of the components they make, which means that they, not a supervisor, are in charge of quality control. The proprietors' business cards sport ISO 9002 marks of manufacturing quality.

Jagadeesan is one of perhaps 45m non-farm units loosely described as "informal" or "unorganised". Many are nothing more than a woman in a slum packing clothes for export; others are bigger than Jagadeesan, with its 32 employees and sales of 19m rupees ($400,000). These truckers, shopkeepers, restaurateurs, incense makers, rickshaw pullers, metal bashers and other unincorporated folk produce the bulk of India's economic output, even in manufacturing (see chart 5). In many industries they have proved formidable competitors to large firms. Informal units account for 60% of gross savings and two-thirds of exports.



This industrial confetti is India's hope: as employment in agriculture shrinks, millions of tiny rural enterprises should pick up the slack. But it is also India's headache. Liberalisers lament that in its Gandhian preference for small producers, India has put up hurdles to growth for firms both small and big. Now both are cowering at the prospect of international competition. By contrast, some humanitarians worry that the informal firms are all too competitive. Because they escape much of the scrutiny, regulation and cost borne by organised competitors, work is shifting from the protected to the unprotected sector, where wages and working conditions can be awful. But there is also evidence of a countervailing trend: links to big firms and to export markets are persuading unorganised firms to observe the norms of the formal world.

Small firms enjoy two sorts of advantage. The first comes from not being noticed, a boon in India's over-regulated, overpriced environment. If a business can look informal enough, it can dodge taxes, electricity bills and minimum wages. The second applies to a different group of firms, which are noticed but favoured. Small companies get all sorts of sops, especially exemption from paying excise taxes, which can make the difference between profit and loss. If a firm is small enough, it escapes laws that stop companies from firing people. If it chooses its products wisely, it may be protected from competition by big companies through the "small-scale reservation". In this jungle of preferences, corruption thrives.

The joys of inconspicuousness

To anyone who wants to cut corners, therefore, small is beautiful. Take rolling *beedis*, the sort of no-frills work that humanitarians fret about. The poor man's cigarette industry employs an estimated 10m people and in 1994 generated about 60 billion rupees ($1.3 billion) of added value. The bulk of its workforce are women who sit at home turning tobacco, tendu leaves and thread into small flammable tubes.

Increased competition since the reforms is prompting big firms to outsource work to smaller vendors, who in turn pass it on to home-based workers. A recent study found slum-dwellers working indirectly for well-known Indian firms, and even some multinationals. Although the working conditions are often wretched, these jobs are providing people with incomes and in some cases skills. They are also ushering women into the workforce, both exploiting and advancing them.

Broadening markets may improve quality and conditions. Jagadeesan, for example, was prodded into action by its sole customer, Sundaram Clayton, the first Asian company outside Japan to win Japan's Deming award for production quality. Facing competition from multinationals, Sundaram Clayton asked its suppliers to upgrade their quality and speed up deliveries without raising prices. Jagadeesan quickly obliged, but this required a bloodless revolution. "Before, everything was secret" from the workers, says J. Selvam, one of Jagadeesan's owners. Now the workers have a lot more information: not only on matters relating to their own jobs, but also on the firm's turnover and profits. They are paid unprincely salaries of 900-2,750 rupees, but they are now supplied with uniforms and meals and such formal-sector benefits as contributions made for them to the public-sector pension scheme, says Mr Selvam.

How to improve your knitting

In Tirupur, centre of Tamil Nadu's knitwear production, the influence of foreign buyers is eroding the industry's cottage character. Processes such as knitting, dyeing and stitching, traditionally carried out in independent units, are being brought under one roof. At the same time, manufacturers in Tirupur, which had a bad reputation for employing child labour, are trying to appear socially responsible. The rise of organised retailing will also encourage firms to formalise. Although India's 12m shops are overwhelmingly one-family operations, chain stores are beginning to pop up, especially in southern cities such as Chennai, Bangalore and Hyderabad. According to Mr Jhangiani of Pleasantime Products, chains are forcing an industry notorious for black money to "come into the accounted economy".

For toys, dereservation has come too late

Crutches that propped up small firms when protection was still rife have become impediments in a freer market. As trade barriers are lowered and customers' preferences shift in unpredictable ways, small, informal companies are discovering their competitive disadvantages. For toys, a sector reserved for small companies until this year, dereservation has come "too late," says Mr Jhangiani. India's biggest toy manufacturer has a few hundred employees; China considers 5,000 the payroll of a small unit, he says. For now, the Indians are partly shielded by a tariff of 40%, but illegal imports evade this. Mr Jhangiani reckons that they are running at twice the volume of the legal sort.

Mattel has shut up shop in India. Pleasantime is coping by turning itself into little more than a packing and marketing operation, outsourcing much of its work to the informal sector. Big orders are farmed out to China, because Indian firms cannot provide the quality and variety needed. "The small sector is going to die a slow death," predicts Mr Jhangiani.

Not the least reason for that is that small companies lack access to credit and marketing budgets to scout for new customers. According to Mr Vaidyanathan, the finance professor in Bangalore, the unincorporated sector borrows mainly from the private money markets, where interest rates are at least twice those offered by government-owned banks. Even plucky Jagadeesan is not in the clear. Its industry is going through a downturn and Sundaram Clayton is demanding more price cuts. Jagadeesan would like to export, but a marketing trip to the United States would all but wipe out the firm's profits.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Islands of quality

May 31st 2001
From The Economist print edition

Where India can compete with the world

Panos

The profits are far from intangible

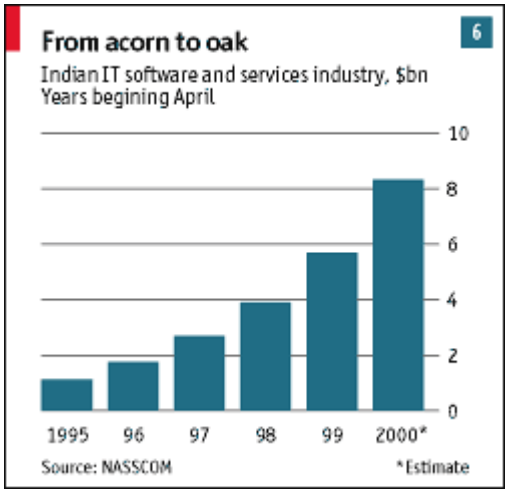
THE Paharpur Business Centre in Delhi offers the sort of amenities its blue-chip tenants expect: resident secretaries, payroll services, leased telecom lines. It also supplies custom-made air. The trees nearby are scrubbed with high-powered hoses to improve the local atmosphere in one of the world's most polluted cities. Indoors, the air is further filtered to near-mountaintop quality. Tenants can monitor Paharpur's air quality on the company's website.

Most of India's "new economy" companies do not go so far as to manufacture their own air, but they do see value in aloofness. Software engineers in Bangalore disport themselves on pristine campuses, fitted out with state-of-the-art gymnasiums. Call centres near Delhi equip themselves with spare telephone lines, back-up generators, and back-ups for the back-ups. Their quality standards, management styles and ideas of corporate governance owe more to western, especially American, models than to the traditions of Indian firms. The gleaming campus in Bangalore of Infosys, India's third-biggest information-technology firm, has a golf green and a Domino's Pizza as the staff canteen. You might as well be in Silicon Valley.

Some critics contend that the new economy has little to offer the vast majority of Indians who are not engineers. Others point out that India cannot live by services alone. There is some truth in both these claims, but the new economy has more bearing on India's fate than first impressions might suggest. It extends far beyond software, its most visible sector. It is already making a noticeable contribution to GDP. Perhaps most important, the new economy is setting an example for the old.

Indian manufacturing may have been ruined by Nehru's dictum that "It is better to have a second-rate thing made in one's own country than a first-rate thing one has to import," but India's brainpower, or at least a sliver of it, remained unaffected. The skewed education system lavished resources on universities and technical academies while neglecting primary schools for the masses. Its graduates are Silicon Valley billionaires, and shakers and movers in India's emerging information-technology industry. India's colonial heritage produced enough English-speakers, some 30m-50m, to populate a medium-sized country. The new economy offered the first commercial activity that appealed to India's educated priestly caste.

Market brahminism has helped point the Indian economy towards the intangible, a direction already encouraged by its industrial shortcomings. Services are growing faster than any other sector. They span a range from banks to tea stalls, but it is the "knowledge industries" that have captured the imagination of India's entrepreneurs. Of these, information technology is the most successful. It has grown at an average annual rate of over 50%, from almost nothing in 1991 to sales of $8.3 billion in 2000 (see chart 6) and employment of around 400,000. It makes up 15% of India's exports. NASSCOM, the main trade association for the information-technology industry, predicts that by 2008 India will export $50 billion-worth of software and allied services, and employ 1.1m people. "IT-enabled services" or "remote services" will expand employment beyond software engineers, potentially to anyone who can speak English.



Unbeatable combination

Whether peddling software or other services, India offers the same deal: work done to global standards, and often at a faster pace, at Indian costs. This is creating a new kind of company. You do not have to spend long at Infosys to find out that, unlike most Indian companies, it regards labour as a scarce resource. Until this year's high-tech downturn, the war for talent at Indian software houses was no less fierce than in the United States. Salaries were rising by 25% a year and companies were commonly losing a quarter of their employees each year. The amenities are designed to keep Infosys's engineers happy. Software firms like Infosys pioneered employee stock-ownership plans. And there is no bowing and scraping.

The campus is also designed to convince potential customers, most of them American, that they sacrifice nothing by outsourcing work to Infosys. "Attention to detail, attention to quality is what is important," says N.R. Narayana Murthy, Infosys's chief executive. On the stockmarket Mr Murthy's reputation is irreproachable. Infosys was the first Indian company to list its shares on Nasdaq and the first to draw up its accounts in accordance with American accounting principles.

India's information-technology sector has defied predictions that it would never outgrow "body-shopping"—simple, low-cost software fixes done at the client's site by Indians armed with an engineering degree and a temporary visa. Indian software houses proved themselves by sorting out western companies' millennium-bug problems, and then went on to win bigger, longer-term and more demanding contracts. IDC, a research firm, reckons that India has 80% of the market for software development outsourced offshore.

Software houses proved themselves by sorting out western companies' millennium bugs

Now the Indian industry's confidence is faltering for the first time. As yet, nobody knows whether the downturn in the United States will hurt Indian software (by delaying companies' investment in new technology) or help it (by encouraging outsourcing to cheaper locations). Already, some American customers have sent some Indian engineers home (B2B means "back to Bangalore", joke the returnees). Most IT firms plan to reduce their hiring this year; at Infosys employees decided, "unanimously", says Mr Murthy, to limit pay increases in India to an average of 15%, about half the level of recent years. Once the uncertainty lifts, he thinks, potential clients will look for better value for money.

The dragon awakes

But there are other worries. For the first time India is looking over its shoulder at China, which could become a competitor, initially at the low end of the market. India has an edge in English and in experience, but the Chinese are thought to be learning fast. Despite the slowdown, India may not produce enough good engineers to meet NASSCOM's growth targets. Quantity is no problem in the short run: 260,000 "knowledge workers" are expected to enter the market this year and next. But NASSCOM admits that not all are good enough for global markets.

Some software companies will not survive the slowdown. A Mumbai-based venture capitalist points out that many IT companies have lots of low-paid drones and a few bosses, but have trouble holding on to the mid-level talent needed to develop higher-value-added services. They are also reluctant to hire expensive marketing people. Infosys is unlikely to be undone by meanness. It has opened offices in Toronto, California, Chicago and London. To strengthen its middle tier, Infosys has started a "leadership institute" where, says Mr Murthy, a thousand people a year will learn to "walk on water." He is aiming for more ambitious assignments. Meanwhile, he notes that Infosys, with 10,000 employees, has some way to go before it catches up with the "big five" IT consultancies.

Knowledge exports do not stop with software services. The idea of outsourcing back-office work to India is catching on among big first-world companies, led by multinationals such as GE and American Express. Indian companies are offering back-office services to firms that do not want to set up their own Indian operations. Daksh.com near Delhi answers questions from customers of Amazon, the biggest online retailer, mainly by e-mail.

In theory, India can export just about any service capable of being carried by fibre-optic cable, from cartoon animation to research and development. NASSCOM guesses that last year 68,000 people were generating 40 billion rupees of revenue in remote services. Some analysts think that India will scoop up clerical work in the developed world, just as China and other East Asian countries commandeered manufacturing.

Some think that India will scoop up clerical work in the developed world

Such predictions reinforce the idea that India's real metier is services rather than manufacturing. When Max India, a Delhi-based company, got the chance to reinvent itself after selling its stake in a Mumbai cellular service, it picked fields where it could exploit middle-class dissatisfaction with services traditionally supplied by the state, such as health care and insurance, and stayed well away from manufacturing.

Even some manufacturers seem to believe that India's edge is in processes such as design and testing. One venture capitalist says he would never make any more bricks-and-mortar investments. Because the banking system is rotten, he says, traditional companies end up being creditors of last resort to their customers: "If you're a big company, you're a bank."

India's most conspicuous old-economy success, Reliance, escaped the country's shortcomings in the same way that new-economy companies have done, by building its own infrastructure and raising its own money. To support its huge energy and petrochemical complex on the coast of Gujarat, it built 240km of roads. "We generate all our own power and control all logistics" says Anil Ambani. The idea is to have "less dependence on critical things we need".

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Knights in tarnished armour

May 31st 2001
From The Economist print edition

India's big businesses have been slow starters and slow learners

"THIS year crisis will be upon Indian industry. We are not ready." So said Ratan Tata, chairman of one of India's biggest industrial groups, not in 1991 but in April 2001. The 1990s were Woodstock, a time of liberation and youthful experimentation but not much discipline for Indian industry. Only now are the pressures of adulthood being felt. Growing up is proving to be painful.

Panos

The two-wheeler of choice

Businessmen by and large saw reform as opportunity without risk. Having got accustomed to investing to suit the whim of government, they could suddenly choose what to invest in and how much. Many did not choose wisely. Private investment boomed, growing 24% in 1994 and 39% the year after. Companies that had diversified by licence diversified some more, from textiles and chemicals into biscuits, from steel into paints and power, from pharmaceuticals into power and finance. Everyone, it seemed, set up a non-bank finance company and, when those went out of fashion, a software-development firm. Their expansion was financed by an indulgent stockmarket and state-owned institutions.

Many were led into new areas by multinationals, which later ditched them. Some multinationals overdid it too. The number of serious car manufacturers rose from three to ten, with Ford, Hyundai, General Motors and Daewoo among the newcomers. They are now among the most vigorous proponents of protection, especially from imported secondhand cars.

The change from chronic shortages to oversupply was a bonanza for consumers. Indigenous products such as televisions and washing machines that relied on outdated technology suddenly faced competition from globe-straddling manufacturers. Prices fell, service improved, and delivery sped up from years to minutes.

Yet to everyone's disappointment, it turned out that India lacked both the double-digit growth and the eight-digit middle class required to earn a decent profit from these investments. So thousands of ventures have disappeared; of more than 1,000 non-bank finance companies, perhaps 200 remain; a generation of private airlines has come and gone; local brands of television have vanished.

Meanwhile, the heights of the economy are commanded by those that lingered on: the public sector, which produces miserable returns on half of India's capital stock, and traditional family-owned firms, many of which are doing no better. R. Ravimohan, managing director of CRISIL, a rating agency, says that a quarter of the companies he rates are safe, a quarter have improved but are still at risk, and half are "distressed." Seven of the ten most valuable companies on the stockmarket in 1992 had disappeared from that list by March 2001 (see chart 7).

The lingering has been made possible by the protection still available to industry, despite stiffer competition. In many sectors imports have been tamed. It was only on April 1st that India dismantled the last of its major import quotas after losing a case before a tribunal of the World Trade Organisation. Until then, manufacturers of consumer goods faced virtually no import competition. India's tariffs remain among the highest in the world.

Ownership patterns, financial institutions, and bankruptcy and labour laws supply more layers of armour, particularly for public-sector companies, which include most of the banking system, as well as the biggest companies making cars, forging steel, selling

petroleum, flying aeroplanes and carrying telephone calls. The government's rhetoric on privatisation has become bolder but it has sold virtually nothing to strategic investors.

Private-sector companies, particularly family-owned ones, have had defences almost as formidable. The family's stake may not always be large, but shares have often been locked up in the hands of friendly state-owned financial institutions. Thus protected, some owners (called promoters in India) have neglected minority shareholders, preferring to extract value from their companies by means other than share price appreciation. A study last year by Surjit Bhalla, who runs Oxus Fund Management in Delhi, found that whereas the main stockmarket index, the Sensex, rose by an average of 16% a year between 1995 and 2000, shares of promoter-owned companies fell over the same period.

Giant-go-round 7

Top companies by market capitalisation, $bn

Company	1992	Company	2001*
Tisco	2.21	Hindustan Lever	10.3
ITC	1.20	Reliance Industries	8.84
Telco	1.14	Wipro	6.65
Century Textiles	1.13	Infosys Technologies	5.79
Hindustan Lever	0.89	Reliance Petroleum	4.65
Reliance Industries	0.77	ITC	4.29
Grasim	0.74	Oil & Natural Gas	4.05
GSFC	0.71	Indian Oil	2.73
ACC	0.67	State Bank of India	2.26
Colgate	0.57	HCL Technologies	2.22

*March

Sources: *Business Today*; Morgan Stanley Capital International

John Band, a broker who has become a one-man movement for minority shareholders' rights, says that half the companies on the stockmarket have delivered such poor returns that they deserve to be taken over. Of that half, he reckons, 90% are safe, either because the promoter's stake is high or because the state they are in is "too shocking". His firm, ASK-Raymond James, is targeting the remaining 10%. Neither he, nor anyone else, has yet staged a successful hostile takeover, but Mr Band's first raid brought forth a white knight who gave his client (and other minority shareholders) a handsome pay-off to go away.

Bankruptcy in India is not a final reckoning. A Board for Industrial and Financial Reconstruction protects everyone connected with an insolvent company but the creditors: factories are kept open, and owners often walk away with whatever assets still retain some value. As Mr Ramesh of the Congress party puts it, there are many sick industries but not many sick industrialists.

Little wonder, then, that corporate reform was limited. According to a study of 3,000 firms, the productivity of Indian industry during the 1990s rose more slowly than in the 1980s. Another study reports that India's labour productivity remains "abysmally low".

The industrial slowdown that began in 1997 jolted companies. Families have transferred management to professionals, for example at Ranbaxy, the biggest pharmaceutical company, and at Murugappa, a Chennai-based agro-business. Many groups have disposed of companies in sectors where they are weak and acquired assets in sectors where they intend to be strong. They include Ballarpur, which sold nine businesses and increased its share of the paper industry, Aditya Birla, a conglomerate that has expanded in aluminium, cement and clothing, and Raymond, which pulled out of steel and cement to concentrate on textiles.

Many companies found they had to upgrade their products. Mahindra & Mahindra, a manufacturer of tractors and other rural vehicles, has trawled the world for technology to build what it claims is the best tractor in India. Shedding flab has also been popular. Payrolls have been reduced through voluntary retirement schemes, other costs through outsourcing, energy conservation and the like. Hindalco, Aditya Birla's aluminium company, is now reckoned to be one of the world's most efficient. Even the public sector has been goaded into action. SAIL, the biggest steel company, is shedding more than 25,000 jobs in a restructuring programme.

Now the hard part

If this were enough, India would be a more impressive performer on the world stage than it is. It does have a number of companies with global scale—in luggage and bicycles, for example—but almost none with a global presence.

Gita Piramal, co-author of a recent book for Indian managers, says companies are only now beginning to realise that profits as well as products must meet global standards. Indian companies are not used to factoring in their cost of capital or to paying workers by performance. The crunch comes when companies install systems for measuring achievement and opening communications. When Mrs Piramal addressed the Bombay Management Association on the need for such changes last year, she faced "extreme anger. Cassandra was the nicest term they used."

VIP Industries, the world's second-largest luggage producer, which is promoted by Mrs Piramal's husband, is taking her medicine. Competition has been fierce for the past decade, both from local manufacturers attacking the lower and middle segments of the market and, more recently, from Samsonite, which has set up a factory to cater to the upper end. Input prices have risen, but demand has been too sluggish to allow VIP to pass them on.

The last time VIP put up a new plant was in 1997. Since then it has been cutting costs by outsourcing, both to Indian suppliers and to China. Both have advantages over big Indian manufacturers. Local suppliers have "far more correlation between output and wages," says Arun Warey, VIP's chief executive. China has that too, plus better infrastructure and raw materials. VIP has cut employment in India by a third, but is adding jobs in China. It can pay the 62% duty on luggage imported from China and "still come out ahead in the Indian market," says Mr Warey.

Now VIP is addressing the toughest part of restructuring, changing the way people are paid and promoted and how they relate to each other. VIP has been linking pay to performance for several years, but is only now formalising the practice. It wants to bring the number of levels in the organisation down and to establish the principle that "promotion is not a matter of routine". It took two years to convince the company's top managers that the changes were necessary.

Vroom, vroom

At least VIP can still sell luggage. Bajaj Auto, by contrast, faced a basic shift in consumer preferences it had not seen coming. Bajaj's bread and butter was scooters; specifically, one particular kind that accounted for two-thirds of the company's sales and profits and needed no marketing. But the family man who was Bajaj's main customer has now moved on to small cars, and younger people do not want scooters but motorbikes. There to provide them was not Bajaj but Hero Honda, a joint venture between a Japanese bike manufacturer and the group that owns Hero Cycles. Bajaj has kept its lead in the geared (manual transmission) scooter market, but that market is plummeting. Ungeared scooters are dominated by two other companies, and half the market for motorbikes belongs to Hero Honda.

"In both segments we have been slow starters, slow learners," says Rajiv Bajaj, the company's president. There was a lot to learn. At first Bajaj concentrated on improving quality and increasing the number of models. It was not until 1995 that the company began to take full advantage of its alliance with Kawasaki, a Japanese manufacturer, to improve styling, upgrade its engines and meet stricter environmental standards. "We didn't learn from Kawasaki for ten years because we thought we knew everything," says Mr Bajaj.

That complacency is gone. Bajaj has made "huge investments" to improve production and enable suppliers to meet the new requirements. Productivity has increased dramatically. In 1993 Bajaj had 23,000 workers, who made 1.1m vehicles; today it has 14,000, who produce 1.4m. Its next project is to improve its network of dealerships. Bajaj has even started to export to the other big two-wheeler markets, which it had all but ignored during its 56-year history. In motorbikes Bajaj has hauled itself up from being number four in the market to number two.

Yet all this has failed to restore Bajaj to health. The company has just completed "the worst year in its history", says Rajiv's father, Rahul Bajaj, who remains chairman. That is partly because the scooter market has slumped. It is also because, despite the flashy new bikes on show at the company's headquarters in Pune, Bajaj has not yet persuaded consumers that its bikes are as good as Honda's.

And now Bajaj is worried about China. Its productivity may be up, but the no-firing rules keep it far below world levels. Indian companies pay more for power, capital and wages than do Chinese competitors, which anyway hide their costs, claims Rahul Bajaj. He wants the government to steamroller the playing field with more reforms. Instead, the government decided in April to lift import duties on two-wheelers from 35% to 60%.

Reforming India is like restructuring a business: one can do a lot, and still be at the beginning. The present government seems to want reform, but it is roughly at the stage where Bajaj was when it realised that it was motorbikes, not scooters, that people wanted.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

A management guide

May 31st 2001
From The Economist print edition

How to run India Inc.

IF INDIA were listed on the stockmarket, it would be a juicy takeover target. A corporate raider would see an enterprise that has raised its game in the past ten years but remains constrained by caution. Surely India's assets could deliver higher returns under new management.

Panos

You have to start somewhere

The new owner's first worry would be an ocean of red ink in which any enterprise might drown. The central government's budget deficit is 5% of GDP; the states' deficits add up to roughly the same again. Fortunately, India finances this shortfall from domestic sources, so it faces no immediate threat of a devastating flight of international capital. Its current-account deficit is less than 2% of GDP. But India pays the price in high real interest rates, which choke off private investment and erode competitiveness.

The buyer's second concern would be that much of the money is being spent on the wrong things. Wages and salaries, interest payments and subsidies take up an inordinate share of public spending, and the subsidies do little to help the poor. Public investment as a proportion of GDP has been declining. India spends less than 1% of GDP on public provision of health care, well below the average for poor countries. Spending on education is also inadequate, at about 3% of GDP.

Correcting this requires the draconian pragmatism one expects from a Wall Street raider. Trimming central and state bureaucracy could save nearly 1% of GDP a year, reckon Jeffrey Sachs and Nirupam Bajpai of Harvard University*. Disposing of non-core businesses—virtually all state-owned commercial activities—would help both the public finances and the industries concerned. And the economy would benefit from better-run airlines, hotels and, especially, banks, whose shortcomings are partly responsible for today's high borrowing rates.

Loss-makers such as electricity, irrigation, railways and universities should not be shut down. On the contrary, they should be revived by allowing them to charge realistic prices and selling off those operations better managed by the private sector, such as electricity distribution. Even schools and health centres can be privately run, as long as the state ensures that they are of acceptable quality and affordable for the poor.

When it comes to the state's natural monopoly over taxation and law, our acquirer would aim for simplicity and transparency. The current management has made a start. Average import duties have been cut from 87% in 1990 to 34% now. The prime minister's Economic Advisory Council recently recommended that they be lowered further to 12% by 2005. One of the main reasons why the share of taxes in GDP slipped during the reform years, from 11% to 9%, is the unwieldiness of India's indirect tax system. The government has already simplified it, but the raider would go further.

In the same spirit, he would do away with the thicket of preferences that seek to protect the vulnerable but end up by immobilising them. That category includes laws to stop companies from sacking workers, and therefore from hiring them; the small-sector reservation; bankruptcy procedures that promote neither revival nor liquidation; restrictions on trading agricultural commodities; and rent controls that make low-income housing unviable.

India is a sprawling conglomerate, best managed not by diktat but by initiative from below. States already have a vital role. Devolution of responsibility to elected village-level government can improve the allocation of resources and monitoring of services such as schools. Decentralisation demands accountability, and the new boss's most urgent job would be to transform India's corporate culture so that officials all the way down to the village administrator embraced the style of governance handed down from the top.

Getting there

It may seem callous to apply a Wall Street metaphor to a process as disruptive as economic reform. There is much in the raider's handbook that would help the poor directly, such as shifting funds away from wasteful subsidies towards investment in health and education. But it must also be admitted that some of it would not. Scaling down protection for small handloom units has pushed some weavers to the wall. In Andhra Pradesh, about 40 weavers have committed suicide.

To alleviate the more painful consequences of reform, the government could spend some of the money it has saved on programmes that simultaneously protect the vulnerable and improve the economy's productive capacity, such as building rural roads. Reform has its casualties, but it is important to recognise how much benefit it has brought India already, and how much more it could bring if pushed further.

The government knows what to do. Seminars, journals and books by the hundred, often the work of the government's own counsellors, all proffer much the same advice on how to raise India's growth rate from 6-7% to 8-9%. The prime minister, Atal Behari Vajpayee, and the finance minister, Yashwant Sinha, both accept the main points. Their three years in office so far, a record since the 1991 reforms, should have given them the confidence and experience to push through the rest of the reform agenda.

Seminars, journals and books by the hundred proffer the same advice on how to raise India's growth rate

They have already done several commendable things, such as opening insurance to the private sector and ending telecoms monopolies, and would like to do more. Mr Sinha's most recent budget, presented in February, was unapologetically reformist.

State governments have not sat still. Madhya Pradesh has an innovative education guarantee scheme that has helped its literacy rate climb nearly 20 points, from 45% in 1991 to 64% this year. Andhra Pradesh has been a pioneer in reforming electricity, transferring control of water usage to farmers and computerising the issuance of government documents, which cuts down on corruption. Tamil Nadu has been a leader in promoting computer education and laying fibre-optic cable. Kerala has the most impressive long-term record, with the highest levels of literacy and life expectancy, and one of the lowest poverty rates in India. Yet no state has succeeded on so many fronts that it can claim to be the model for all others. Kerala, for all its successes, is better known for exporting its well-educated sons and daughters than for importing capital.

Unfortunately, reformers have even less power to hire and fire than do industrialists. Mr Sinha is stuck with a score of coalition partners, many of whom are suspicious of reform. Parliament, which must approve measures such as liberalising labour legislation, does not seem to grasp that such changes are preconditions for creating jobs. Groups that feel victimised by reform usually shout louder than potential beneficiaries. In Chhattisgarh, carved out from Madhya Pradesh last year, the founding chief minister (a member of the opposition Congress party) has made his reputation by backing a two-month strike at a newly privatised aluminium plant. This may well drive investment away from his fledgling state, but his constituents may never notice.

Yet countries are not corporations, and no despotic financier is about to seize control of India's democracy. The current managers will keep their jobs, or be replaced by people with a similar outlook. They will persist with reform, pushed a bit faster, perhaps, by straitened public finances and by the progressive liberalisation of imports. But the pace is unlikely to satisfy those who yearn for growth close to double figures, as all Indians should. The Planning Commission recently concluded that 8.7%, the rate needed to double income per head over the next ten years, is out of reach, and has instead proposed 8% as the growth target for 2002-2007. India has gained a plot, but it is unfolding excruciatingly slowly.

---

* "The Decade of Development: Goal Setting and Policy Challenges in India". Center for International Development at Harvard University. 2001.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Acknowledgements and sources

May 31st 2001
From The Economist print edition

Many people helped the author with his research for this survey. In addition to those mentioned in the text, he would particularly like to thank Swaminathan S. Anklesaria Aiyar of the *Economic Times*; Titoo Ahluwalia, chairman of ORG-MARG; Mahesh Vyas, executive director of the Centre for Monitoring Indian Economy; and Ratna Sudarshan of the National Council of Applied Economic Research.

"The Challenge of Reform: How Tamil Nadu's Textile and Apparel Industry is Facing the Pressures of Liberalisation". By Meenu Tewari. Paper prepared for the Government of Tamil Nadu and the Center for International Development, Harvard University. Revised Draft. January 2001

"The Decade of Development: Goal Setting and Policy Challenges in India". By Jeffrey Sachs and Nirupam Bajpai. Center for International Development, Harvard University

"Doing Business in India: What Has Liberalisation Changed?". By Naushad Forbes. 2000

"Economic Reforms: A Medium-Term Perspective". Prime Minister's Economic Advisory Council

"Economic Reforms and Poverty: A Tale of Two Surveys". By Deepak Lal, Rakesh Mohan and I. Natarajan. *Economic and Political Weekly*. March 24th 2001

"Economic Survey 2000-2001". Government of India

"Employment-Unemployment in the 90s: Results from NSS 55th Round". By K. Sundaram. *Economic and Political Weekly*. March 17th 2001

"Growth, Poverty and Reforms". By Jagdish Bhagwati. *Economic and Political Weekly*. March 10th 2001

"The Impact of India's Economic Reforms on Industrial Productivity, Efficiency and Competitiveness". National Council of Applied Economic Research. 2001

"India: Reducing Poverty, Accelerating Development". World Bank 2000.

"The IT Software and Services Industry in India: Strategic Review 2001". NASSCOM

"Managing Radical Change: What Indian Companies Must Do to Become World-Class". By Sumantra Ghoshal, Gita Piramal and Christopher A. Bartlett. Viking. 2000

"Mid-Term Appraisal of Ninth Five-Year Plan (1997-2002)". Planning Commission. October 2000

"Productive Linkages of Indian Industry with Home-Based and Other Women Workers through Subcontracting Systems in the Manufacturing Sector". By Ashok Raj and Rakesh Kapoor. 2001

"Productivity in Major Manufacturing Industries in India: 1973-74 to 1997-98". By Pushpa Trivedi.

"State-Level Performance under Economic Reforms in India". By Montek S. Ahluwalia. March 2001

"Voices of the Poor: Poverty in People's Perceptions in India". By V. M. Rao, Alakh N. Sharma and Ravi Srivastava. Institute for Human Development, New Delhi

"Agricultural Growth, Rural Employment and Poverty Reduction: Non-Tradables, Public Expenditure and Balanced Growth". By John W. Mellor. Abt Associates. March 2000

"Television and Social Change in Rural India". By Kirk Johnson. Sage Publications. 2000

"Values of Destruction: Indian Promoters, 1995-2000". By Surjit S. Bhalla and Rohit Chawdhry. December 2000

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Offer to Readers

May 31st 2001
From The Economist print edition

Reprints

Reprints are available should you wish to order extra copies of the survey. Please send your request to the relevant region:

World-wide (excluding North America):

Rights and Syndication Department
26 Red Lion Square
London
WC1R 4HQ
United Kingdom

Tel: +44 (0)20 7576 8000
Fax: +44 (0)20 7576 8492
E-mail:rights@economist.com

North America:

Rights and Syndication Department
111 West 57th Street
New York
NY 10019
USA

Tel: +1 212 541 0532
Fax: +1 212 641 9808
E-mail:usrights@economist.com

Corporate offers and customised reprints

For corporate reprint orders of 500 or more and customisation options, please contact the Rights and Syndication Department in the relevant region:

World-wide (excluding North America):

Rights and Syndication Department
26 Red Lion Square
London
WC1R 4HQ
United Kingdom

Tel: +44 (0)20 7576 8000
Fax: +44 (0)20 7576 8492
E-mail:rights@economist.com

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

E-Strategy brief: Siemens

Electronic glue

May 31st 2001
From The Economist print edition

The third in our series on e-strategies looks at Siemens and asks whether, by embracing the Internet, a conglomerate can become more cohesive

THERE is an old saying in German business: "If Siemens only knew what Siemens knows." It sums up both the strengths and the weaknesses of this huge German electronics and electrical-engineering company. On the plus side, the company is renowned for the technical brilliance of its engineers. If somebody at Siemens has a question, somebody else in the company is likely to know the answer.

The difficulty lies in putting the two together. Siemens is a sprawling conglomerate with more than a dozen business units that make almost everything from light bulbs to power-generation equipment (see table). It operates in 190 countries and employs 470,000 people. In such a vast empire, useful knowledge is easily wasted.

Bits and pieces

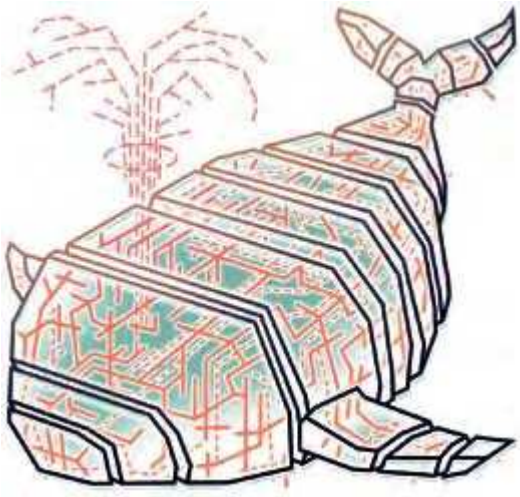
Siemens's revenues, by unit 2000*, €m

Information and Communication Networks	11,218
Information and Communication Mobile	8,870
Business Services	4,273
Automation and Drives	6,892
Industrial Solutions and Services	3,339
Production and Logistics Systems	1,598
Building Technologies	4,519
Power Generation	8,239
Power Transmission and Distribution	3,131
Transportation Systems	3,992
Automotive	3,834
Medical Solutions	5,038
Osram	4,039
Infineon	6,200

*Year ending September, external sales only
Source: Company report

Heinrich von Pierer, Siemens's chief executive since 1992, has a favourite example of how much Siemens could gain by exploiting its knowledge to the full—or could lose if it does not. Siemens Malaysia wanted to bid to supply a high-speed data network linking Kuala Lumpur and its swanky new airport, but lacked the necessary know-how. Somebody thought to check the "sharenet", an internal system on which knowledge is posted for use throughout the company, and found that Siemens was already working on a similar project in Denmark. The people in Malaysia were able to adapt what had already been done there, and won an order for a pilot project. In future, proclaims Mr von Pierer, his company hopes to be able to say: "Siemens knows what Siemens knows."

The key to this change is e-business. Siemens is spending *euro*1 billion ($860m) in a bid to turn itself into an e-company. Or should that be an e-conglomerate? In effect, Siemens's investment is a huge bet on the idea that modern information and communications technology can knit the different parts of its far-flung empire into a more coherent whole.



Conventional wisdom speaks against conglomerates. Financial markets dislike them, rating conglomerates' shares up to 20% below what they think is the value of the sum of their parts. Usually, investors prefer to take on a mixture of risks of their own choosing, by buying the shares of different companies, rather than accepting the pre-packaged choice of a chief executive.

Such investors listen sceptically when conglomerates defend themselves. Opportunities for cross-selling or cost sharing are rarely as extensive as the bosses like to imagine. Increasingly, companies have bowed to market sentiment, defined a "core" business and sold the rest. Even Siemens has narrowed its scope, selling most of Epcos, a components manufacturer, and a minority stake in Infineon, a semiconductor maker, in the past couple of years.

Can Siemens confound convention? Not long ago, it would have seemed an unlikely Internet pioneer, for all its technical brilliance. It lacked the informality and flexibility of smaller, younger companies. One joke about Siemens has it that a new-born baby found on the steps of its Munich headquarters could not possibly have had anything to do with the company—because never in its life has it created something new in as short a time as nine months.

It has not even been much good at making money. Peter von Siemens, a member of the founding family who sits on the supervisory board, is said to have remarked that the prospect of returns like Siemens's would not entice a greengrocer to open a shop.

The company has not lost the ability to disappoint. It mistimed its big push into mobile-phone production and had to junk the optimistic forecasts that it was making only a few months ago. Its mobile-phone business lost *euro*143m in the three months to March. Its information and communications division has announced 8,000 job losses so far this year.

For all that, Siemens is generally in better shape than it was. Its net profit margin, a feeble 2.6% in 1995-96, had perked up to 4.3% (after stripping out extraordinary gains) by 1999-2000. In large part, that was the result of new management techniques, introduced by Mr von Pierer, that were once unthinkable. Around 60% of managers' pay is now performance-related. Many employees qualify for share options.

The chief executive is also trying to loosen the company's old, stuffy culture. Siemens people nowadays work in smaller groups. An e-mail about Siemens's e-business initiative that Mr von Pierer sent last summer to all employees elicited "thousands" of replies. Would past Siemens bosses have asked for advice from the ranks? Albert Goller, head of the company's "centre of e-excellence" at Munich airport, says: "To be fast is more important than to be perfect." Would past Siemens managers have said that?

Such willingness to shake up the organisation ought to mean that Mr von Pierer makes a decent return on his *euro*1 billion. Academics and businessfolk have found that investment in information technology works best when it goes hand-in-hand with organisational change. Erik Brynjolfsson, an economist at Massachusetts Institute of Technology who has looked into the effects of IT investment on the productivity and profitability of firms, has found that the return is far bigger in companies that are also prepared to change work practices, strategies and the products and services they sell. Investment in IT and "organisational" investment complement each other: each feeds the return on the other*.

Taking things apart

The danger lies in using IT purely as a way of doing more cheaply the same old things in the same old ways: processing information more cheaply in the same departments, or automating an otherwise unchanged production line. One top executive at a big high-tech company says that companies have to be prepared "to take things apart". Customer information, for example, should not be jealously guarded by the sales and marketing departments, but shared with production departments too. It is not enough for chief executives to understand what has to be done. They have to make sure that change is forced through: often, that means getting involved in details.

Siemens's bosses seem to be in tune with all this. Mr von Pierer talks of the necessity of having an "e-mindset". Mr Goller says: "For me the Internet is about two parts. One is the technology part and the other is the mindset, how we view our business."

In practice, Mr von Pierer's plan has four elements. The first is knowledge management—of which the sharenet is an example. The second is online purchasing. At the moment, electronic buying accounts for 10% of Siemens's *euro*35 billion annual procurement bill. The plan is to raise this to 50% within three years. Most of the savings are expected to come from the exploitation of scale, pooling the previously fragmented demands of several purchasing departments for office equipment, furniture and so on into a single stream, using a company-wide platform called click2procure.

The third element is Siemens's dealings with its customers. Mostly, these are other companies, not retail customers. From about 20 countries, you can click on "buy from Siemens" on the company's home article and place orders for cordless and mobile telephones, spare parts for trains or (in Finland) vacuum cleaners and cleaner bags. Siemens's automation and drives division, to take one example, generates some 30% of its sales online. Almost all its sales should be online by 2005.

The fourth part of the strategy is to change the company's "value chain". Some of this is administrative. For instance, 30,000 job applications a year are now handled online. The business travel of all European employees and most in the Americas (who together make up almost 90% of the company total) is now supposed to be booked over the Internet. For the most part, it is. Unlike some American companies, Siemens has not had to resort to fining those who do not book online.

However, there is more to this than paperless administration. The idea is to make sure that the chain—going from customers, through Siemens, and then on to its suppliers—is as smooth as possible. Hitherto, different bits of Siemens have developed their own e-businesses, from websites to proprietary EDI and ERP systems, more or less independently. Links in the demand chain have been snaggled by the need to deal with several different information systems. "Before e-business," explains Mr Goller, "it was almost impossible to connect all these different systems in order to get information to flow from your customer to your supplier."

The shift to becoming an e-conglomerate should also expand the number of potential customers and suppliers. EDI, explains Mr Goller, has been useful mainly to big companies. In principle, anyone with Internet access, whether they are big or small, ought to be able to trade with Siemens.

Look at the airport, says Mr Goller, pointing outside his window. Several of Siemens's business units could sell something to such a customer. That, he says, is a big advantage of the company's wide range of activities. But he adds: "I don't think that in the future such a customer will tolerate four or five different views about Siemens. They want one view of our capabilities." Even if a customer is buying things from several different Siemens divisions, it should deal directly with only one, which should act as a sort of lead manager within the company. Inside Siemens, the customer should be identified by only one code.

The hard part

In all, Mr von Pierer expects to cut costs by 2% in the short run and by 3-5% in the "medium term". Of the four elements of his strategy, he expects e-procurement to yield the quickest returns. However, they will also be the easiest. "If you want to transform a company to an e-business company," he told analysts in February, "the problem is not so much e-procurement and the face to the customer. All this can be done rather fast. What is truly difficult is to reorganise all the internal processes. That is what we see as our main task and where the main positive results will come from."

Working out this "truly difficult" part is Mr Goller's job. The key, he says, is to marry the present fragmented array of company-wide information systems together, using a "corporate approach". That means agreeing on (and occasionally imposing) some standards across the Siemens empire, and not allowing semi-autonomous kingdoms to go their own way. So deals have been signed with two American software companies: i2 Technologies, which will provide a supply-chain software platform, and Commerce One, which is supplying software on the purchasing side of Siemens's business.

For those who believe that the Internet is best exploited by letting a thousand flowers bloom, all this may come as a surprise. In turning itself into an e-company, the sprawling Siemens empire will become more centralised, not less. So, far from empowering local managers, the Internet increases the authority of those at the centre. Yet this makes perfect sense. If you think that the various parts of Siemens belong under one roof, they surely ought to speak the same e-language, to share information and to sell things in partnership, rather than tripping over each other's feet. And if organisational changes are going to be pushed through, they have to be decided at the top.

Mr Goller says that he has been encouraged by the willingness of executive and second-tier management to accept the necessity of change. There is much more openness to change, he says, than there was in the past.

The Internet ought, therefore, to make Siemens a more cohesive, less unwieldy conglomerate. Yet is this the only or the best use of the new technology? Economic theory could point in a completely different direction.

A prime reason why economic activity is organised within firms rather than in open markets is the cost of communication. The costlier it is to process and transmit information, the more it makes sense to do things in firms; the cheaper communication becomes, the more efficient (relatively) markets will be. Because the Internet and other inventions have cut the cost of communication so much, firms ought to

be able to do less in-house and to outsource more. In 1999 General Motors, a by-word for vertical integration, spun off Delphi Automotive Systems, one of its supply divisions, for instance.

So should the advent of the Internet have prompted Siemens to sell more businesses, or even to break itself up? Arguably, yes. The Internet may make a conglomerate cheaper to run; but it could also make other forms of organisation cheaper still.

---

* “Beyond Computation: Information Technology, Organisational Transformation and Business Performance”, by E. Brynjolfsson and L. Hitt, *Journal of Economic Perspectives*, Fall 2000. This and other papers can be found on Mr Brynjolfsson’s website: http://ebusiness.mit.edu/erik.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Alcatel and Lucent

The runaway bride

May 31st 2001
From The Economist print edition

The wedding of the week was called off at the last minute. Where does that leave the prospective bride and groom?

Schacht ran away, Tchuruk's left behind

THEY had already booked the St Regis Hotel in New York for a grand reception and press conference on May 30th. But Alcatel and Lucent called off their proposed merger at the last minute on the preceding day. Lucent's chairman and chief executive, Henry Schacht, walked out of talks in Paris when he realised that Serge Tchuruk, his counterpart at Alcatel, was not proposing a merger of equals but a French takeover of the ailing American telecoms-equipment group that was spun out of AT&T five years ago. More than a month of negotiations had resolved almost every detail but this, the most crucial of all.

Lucent wanted an equal split of the board, with both companies appointing eight members. But Mr Tchuruk insisted on having a say in at least nine of the 16 appointments. The full story, however, is more complicated than that. It was a classic case of cold feet, with Mr Schacht afraid that Lucent's shareholders would balk at the conditions he had negotiated.

The deal would have offered Lucent shareholders no premium over the current share price, valuing the American company at $22.8 billion, excluding its remaining 58% stake in Agere Systems, an optical-components business that Lucent floated in March. This valuation would have left Alcatel with a 58% share in the combined company, to Lucent's 42%.

Given this ratio, Mr Tchuruk was never likely to accept equal representation on the board—even though, in some respects, Lucent was a perfect partner for him. The French company's American sales accounted for only 22% of its revenues of $29 billion in 2000—a weakness that Lucent, with its long-established relationships with almost all the American carriers, should have been able to remedy.

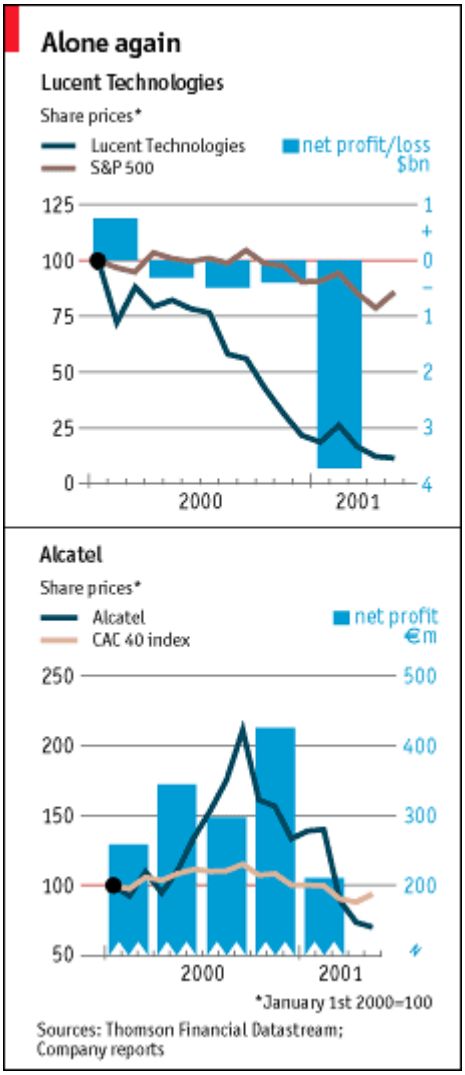
Yet the deal could have turned into one of those deeply disturbed transatlantic alliances, all too reminiscent of the DaimlerChrysler "merger". That too began with the gloss of a marriage between equals, but turned out to have one party uncomfortably more equal than the other. In the longer term, Alcatel and Lucent may be relieved to have pricked the pretence of equality before they reached the altar.

Working against an Alcatel-Lucent link later on would have been the sheer size of the undertaking, a colossus with more than 230,000 employees—over 100,000 from Lucent and 130,000 from Alcatel. Overcoming the cultural differences between them would have been difficult, especially in the face of the lay-offs required to deliver the merger's projected cost savings of $4 billion a year. Industry analysts reckoned that between 20,000 and 30,000 jobs would have had to go.

Where to now?

Neither party to the failed deal can afford to sit tight. The French firm remains the more attractive of the nearly-weds, but on the same day that the merger collapsed it announced that it expects losses of $2.6 billion in the current quarter, mainly due to writing off bad investments in start-up communications carriers such as Canada's 360networks.

Since he took over in 1995, Mr Tchuruk has transformed Alcatel from a cumbersome conglomerate with low morale and lower profits into a focused telecoms business, betting successfully on broadband Internet access, optical networks and big telecoms data switches. His success there, and in previously turning round the oil company Total, have put him among France's industrial elite. Last year he was voted "Manager of the Year" by a French business magazine, *Le Nouvel Economiste.* He sits among the great and the good on the board of Vivendi, whose $34 billion purchase of Seagram's Universal business a year ago was the apogee of Franco-North American deals.



A deal with Lucent would not only have enlarged Alcatel's meagre footprint in America; it could also have been the crowning glory of Mr Tchuruk's career, if he had made it the ultimate turnaround. An active 63-year-old and a driven outsider—the son of Armenian immigrants, born Serge Tchurukdichian in Marseilles—he needs only to prove himself on the global stage. And he is geared up for it. He worked for Mobil for 15 years and speaks excellent English, albeit with ample Gallic gesticulation; he has made English the official language of Alcatel; he was even prepared to move to Lucent's New Jersey headquarters to run the merged entity. Now, for a while at least, he needs to look elsewhere for a defining deal.

Lucent, meanwhile, is in more urgent need of drastic action. In the first half of its current fiscal year, the firm posted a loss of $4.2 billion. To survive, it had to borrow billions and to take Agere Systems public. It is also trying to sell its fibre-optics business, which could raise $5 billion—but is having problems finding a buyer.

Like its competitors, the company has been hit hard by the steep fall in demand for telecommunications gear in recent months. But many of its problems are of its own making. In trying to take on rivals such as Cisco and Nortel Networks, it overstretched itself. To meet its growth target of 20% last year, Lucent borrowed from the future, mainly by using creative accounting and aggressive lending ("vendor finance") to upstart carriers like One.Tel, which this week went into administration. The man held responsible for this disastrous strategy, Richard McGinn, was sacked in October. Mr Schacht, the company's first chief executive, was brought out of retirement to restore Lucent's fortunes. It was he who approached Alcatel.

The two companies have at least one challenge in common. The days of telecoms-equipment giants, which offer an entire range of products and services, may be numbered. They could soon be replaced by the more focused vendors that have already appeared in strength in some sectors. Particularly in the fast-growing markets for optical and Internet gear, telecoms-service providers increasingly prefer to buy the best products they can find—from firms such as Ciena and Juniper Networks, for example—and then to integrate them in-house. Indeed, the failed merger this week may have spared the world the spectacle of two dinosaurs threatened with extinction vainly attempting to mate.

It may also have been a missed opportunity for America. For all the cries from Washington politicians about European plundering of an American treasure—in particular of Lucent's Bell Laboratories, a legendary research lab that invented the transistor—the merger, if consummated, could have been just the latest in a string of American triumphs at offloading industrial has-beens into foreign hands.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Gazprom

Miller rising

May 31st 2001 | MOSCOW
From The Economist print edition

Russia's biggest and most important company has a new boss

REFORM in Russia has been bogged down this year. But the latest Kremlin-backed management putsch at Gazprom, the country's largest company, has made things look different. Under its outgoing boss, Rem Vyakhirev, Gazprom was more like a badly run country than a publicly traded energy company; it had its own intelligence service, aircraft, hotels, media outlets, even a yacht club. Under the noses of its western auditors, billions of dollars of assets and cash leaked to companies whose ownership was at best murky.

Reuters

Vyakhirev (left) no longer turns the taps

Mr Vyakhirev's contract ran out on May 31st. Until the board meeting the previous day, the betting had been that he would hang on to his job, at least for a while. It was said that Vladimir Putin's government, despite its 38% shareholding, did not have the stomach for a real fight with Russia's richest and most powerful business.

In a six-minute meeting on May 30th, however, Mr Putin briskly scotched this theory. He told the Gazprom board that he was instructing the five government-nominated directors to vote for Alexei Miller, at present a junior energy minister. He "suggested" that the other six board members did likewise. They took the hint. With a presidential footprint on his bottom, Mr Vyakhirev departs upstairs, cross and very surprised, to become (non-executive) chairman.

Mr Miller worked closely with Mr Putin in St Petersburg's local government ten years ago. Like the president himself, he is being thrust into a demanding job after a nondescript career. If the Kremlin is serious about reforming Gazprom, rather than just taking control of it, the next thing will be to purge the management board of Mr Vyakhirev's cronies, and hire people capable of making sense of company finances that might politely be described as labyrinthine. And both the new team and the Kremlin will also have to juggle the competing interests of export customers, who pay real money and want increasing quantities of Russian gas, with domestic customers who pay next to nothing, waste a lot, but wield much political clout.

All this will be a long haul, but there is now at least the chance of change for the better at Gazprom. Elsewhere, complacent cynicism about the Kremlin is giving way to nervous questions about what and when Mr Putin will bite next.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Football finances

Fifadom

May 31st 2001
From The Economist print edition

The company marketing next year's World Cup is suspected of fraud

Get article background

EPA

FIFA's entertaining side

ON MAY 21st ISMM, a private Swiss holding company, was declared bankrupt with estimated debts of SFr1 billion ($560m). This week FIFA, football's world governing body, requested an investigation into possible fraud by two of ISMM's senior executives. The ISMM group, the world's biggest sports-marketing organisation, was FIFA's partner for the marketing and television rights for FIFA's World Cup competitions in 2002 and 2006. FIFA is unable to quantify the financial loss that it will suffer as a result of ISMM's collapse.

Sepp Blatter, the autocratic Swiss president of FIFA, faces a testing emergency meeting of the organisation's executive committee on June 12th. One of the committee's vice-presidents, Lennart Johansson, who is president of UEFA, the governing body for European football, which is owed SFr22.5m by ISMM, has written to him demanding an explanation of all the issues relating to the firm's collapse. Mr Blatter defeated Mr Johansson for the presidency of FIFA in 1998.

What are the questions Mr Blatter has to answer? As right-hand man to his Brazilian predecessor, Joao Havelange, he played a leading role in the sale of the rights for the next two World Cups. The two men recommended ISMM's joint bid with Kirch, a German media group, for the TV rights. IMG, an American company competing against ISMM for the rights, complained at the time that the bidding process was a "cosmetic exercise". In July 1996, FIFA's executive committee approved in principle ISMM's bid for the TV rights by nine votes to six, with three members abstaining.

Until its bankruptcy, ISMM was handling the marketing for the next two World Cups, as it has done for every World Cup since the firm was founded in 1982 by Horst Dassler, a former boss of Adidas and son of the sportswear firm's founder. Minutes of FIFA's executive committee's meetings in 1997 show that some members had expressed reservations about the implementation of the marketing deal for 2002 agreed with ISMM. Given FIFA's long-standing and close relationship with ISMM, its request to the Swiss authorities for a fraud investigation into two senior executives at the firm is highly embarrassing for Mr Blatter.

Payments received by ISMM for the resale of TV rights were supposed to go into an earmarked bank account. FIFA had the right to check that payments from the TV companies went into this account when contractually due. However, FIFA has discovered that last September ISMM negotiated a special deal with TV Globo, a Brazilian company, under which TV Globo received a discount for early payment of an instalment due this July. According to FIFA, the two ISMM executives, rather than paying the money, some SFr90m, into the earmarked account, paid it into another ISMM account. FIFA claims to have documents to back up its allegations. The ISMM executives deny FIFA's allegations and say the money was a loan.

FIFA has begun an urgent investigation to establish whether ISMM struck similar deals with other TV companies and failed to pay their money into the earmarked account. Until this investigation is completed, FIFA does not know if any more TV money is missing.

FIFA says that it has already received SFr334m of the minimum of SFr650m that ISMM had guaranteed from its resale of TV rights outside Europe and America for next year's tournament. FIFA is hoping that any shortfall from the rights, other than through suspected fraud, will be limited if Kirch exercises an option to acquire those rights that ISMM held.

Its exposure may be greater, however, on the tournament's marketing rights. Since ISMM's bankruptcy, FIFA has set up its own marketing company to handle these rights and has recruited as many as 50 former ISMM employees to run it. The considerable costs of servicing sponsorship and licensing deals will now fall on FIFA. In addition, FIFA has had to ask the official sponsors of next year's tournament to provide details of their agreements with ISMM and the payments that they have made. (FIFA was expecting the marketing rights to raise SFr400m.) In an explicit acknowledgment of past mistakes, Mr Blatter said that in future FIFA would not sell marketing rights to third parties.

As if all this were not enough, a German newspaper has alleged that ISMM maintained a slush fund in a Liechtenstein foundation, called Nunca (Spanish for "never"), to pay bribes to senior sports administrators. Mr Blatter has denied any contact with, or knowledge of Nunca, but admits that he has been offered bribes, which he has never accepted, in return for contracts. FIFA says it has no knowledge of the Liechtenstein foundation and that it will make an announcement when forensic accountants have completed their investigations.

One more serious setback for Mr Blatter is that FIFA has suddenly called off its 2001 World Club Championship, due to be held in Spain in July and August. Mr Blatter faces awkward questions about this fiasco, especially as the tournament, first held in 1999, is his own creation.

Traffic, a Brazilian firm that is FIFA's marketing partner for the event, had not signed any TV or sponsorship deals for this year's tournament. Strangely, FIFA has attributed the cancellation to the demise of ISMM. Among the questions that Mr Blatter will be called upon to answer is why Traffic was chosen for the job, and the extent of the losses that FIFA will suffer. It will be some time before the full extent of FIFA's financial loss emerges. But Mr Blatter may be lucky to survive.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Correction

May 31st 2001
From The Economist print edition

In our article on makers of branded and generic drugs ("Protection racket", May 19th), we said that the American patent on one of Aventis's best-selling heart drugs expired in 1998; in fact it will expire in 2011. We also said that the Federal Trade Commission had concluded that the arrangement between Aventis and Andrx had blocked market entry of competitors. The FTC actually concluded that the arrangement had not blocked new entrants, although it has moved to bar such arrangements in future because of their potential to do so. We apologise for these errors.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Li & Fung

Link in the global chain

May 31st 2001 | HONG KONG
From The Economist print edition

A surprising world leader in supply-chain management

LI & FUNG used to introduce western retailers of clothes, toys and the like to the sweatshops of China. As such, it was no different from countless Chinese firms: eclipsed by western trading empires such as Jardine Matheson for much of the 20th century and (so it seemed) by the disintermediation wrought by the Internet at the century's end. But when Victor and William Fung, the brothers who today run the family business, sat down to think about globalisation and what it means for Asia, they came up with a winning new strategy for their company.

To them, globalisation meant above all specialisation, and specialisation brings complexity. If the supply chains of companies once consisted of five links, they might soon have dozens, or even hundreds, they surmised. "Somebody's got to pick up these pieces and bring them back together," says William Fung, the younger brother—which is what Li & Fung is now doing, to all appearances better than its rivals in the West.

It works like this. Say a European clothes retailer wants to order a few thousand garments. The optimal division of labour might be for South Korea to make the yarn, Taiwan to weave and dye it, and a Japanese-owned factory in Guangdong Province to make the zippers. Since China's textiles quota has already been used up under some country's import rules, Thailand may be the best place to do the sewing. However, no single factory can handle such bulk, so five different suppliers must share the order. The shipping and letters of credit must be seamless, and the quality assured.

Co-ordinating all this is the challenge of globalisation. "There's always been a supply chain, but no management of it," says William Fung. And this requires knowledge. Village women with sewing-machines in Bangladesh are not on the Internet. Finding the best suppliers at any given time, therefore, takes enormous research—so much, indeed, that companies are increasingly deciding that it no longer pays to do it in-house. Instead, they outsource the knowledge-gathering to Li & Fung, which has an army of 3,600 staff roaming 37 countries ("a machete in one hand, a laptop in the other," as Victor Fung likes to caricature them) for the purpose.

In this sense, Li & Fung is itself a product of specialisation. A company that focuses entirely on optimising supply chains for other companies is a recent phenomenon. The European clothes retailer in our example used to design garments as well as plan its own production; nowadays, it concentrates on the design and hires Li & Fung to handle the logistics.

Which is why the Internet is not proving to be the threat that it once seemed. There are indeed companies in Asia that have based their entire business model on introducing buyers to suppliers via the web—Alibaba in China and Global Sources in Hong Kong are the best-known. But none matches the growth of Li & Fung. It uses the Internet to make supply chains more transparent, but it never confuses the Internet with knowledge. Its real value lies in its power to influence factory owners, leaning on them to reserve capacity, monitoring quality, and so forth.

The company is now so successful that it is strange it does not have more competition. There are rivals, of course—Li & Fung has already bought the main one, also based in Hong Kong. But for now, the firm has a head start in Asia.

What could disrupt that success? Capacity constraints—a ceiling in other industries—are not an issue since Li & Fung manages, but does not own, factories. With every new customer, it simply penetrates deeper into Asia to find suppliers. Some equity analysts (the Fungs listed shares in their company in 1992) worry that a downturn in America and Europe could hurt demand, but William Fung is sanguine. Pressures on western retailers only make them outsource even more of their supply chain to save costs. Since knowledge, of the down-to-earth Asian sort, is really all that Li & Fung has to offer, the company

would appear to have as bright a future as globalisation itself.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

French railways

Très grand void

May 31st 2001
From The Economist print edition

World class in both speed and losses

LOUIS GALLOIS, the boss of SNCF (the French state railway operator), was radiantly happy glugging champagne in front of the television cameras last weekend, after a French high-speed train (TGV) had matched Japan's world record for long-distance speed. The TGV covered the 663 miles (1,067km) from Calais to Marseilles in three-and-a-half hours, at an average speed of 190 miles an hour (306kph). At one point, the train clocked 366kph, in a stunt organised by Mr Gallois to publicise the opening next week of the high-speed service from Paris to Marseilles. But it was of more than symbolic importance. It means that the impressive TGV network now covers the entire length and breadth of France.

AP

France's expensive toy

Viewed from the English side of the Channel, the achievement is breathtaking. Once the new TGV service starts, it will be possible to travel from London's Waterloo station to Marseilles in about six hours—two hours fewer than it takes to travel by train from London to Inverness in Scotland. There is talk of a direct train from Waterloo to the new Marseilles St Charles station. For Parisians, it means they can escape the cold and wet of the French capital to reach the balmy Côte d'Azur in just three hours—one hour 20 minutes less than the old service.

But there is another side to this tale of *gloire*: the French may rival Japan in their brilliant inter-city rail network, but, as taxpayers, they pay dearly for the privilege. There is a huge black hole in the railways' accounts, into which billions of euros are poured each year. And there are parts of the network (notably the Ile de France area around Paris) where consumers are revolting against the horrible state of a train service that is reminiscent of southern England's, with traffic outgrowing capacity and track and rolling stock wearing out too quickly.

On the surface, it looks as though the railways are making only a small loss of FFr1 billion ($130m), the figure expected this year after punishing strikes over Easter. But that is just the tip of *un très grand iceberg*. The real horror of French rail finances is buried in another company, called Réseau Ferré de France (RFF). RFF owns the track and signals, and charges SNCF, the sole national operator, for access. But it pays SNCF, in turn, for managing the network.

In the mid-1990s, the European Commission was pressing the French to separate track and rail operations in the interests of greater financial transparency, and also to open the way for some competition on the tracks. Eventually, the French opted for separation in 1997, but for a different reason: SNCF as it was then constituted was going as bust as only a nationalised industry could, halfway through spending FFr300 billion on its TGV network. So the huge debts were shunted into the new state-owned company—where the grim financial picture is still tucked away.

The accounts for 2000 show RFF running at a loss of *euro*1.7 billion a year. But the true figure is in fact much higher, because there is, in addition, a subsidy from the government of *euro*1.6 billion. Now that SNCF is itself slipping back into the red, that means that the total losses on French railways are around *euro*3.5 billion a year.

And the future looks even bleaker. The long-term debt inherited by RFF has risen from *euro*20.7 billion four years ago to *euro*22.8 billion, and there is little prospect of reducing it by much. So, over the past three years, under a programme known as "reform of reform", the company has tapped the international capital markets for loans worth *euro*18.5 billion, not to spend on shiny new lines but just to refinance its old debts.

As a result, RFF pays interest charges amounting to *euro*2.4 billion a year. That is almost as great as its biggest trading expense, the *euro*2.6 billion it pays to SNCF for managing the network . Since the state guarantees the debt, RFF gets an extra subsidy in that it does not have to pay full market interest rates. In addition, RFF in its first four years enjoyed about *euro*5.4 billion of capital provided by the state. Each year the government puts in new equity to cover the loss: last year the figure was *euro*1.9 billion.

RFF is supposed to get itself into profit and start paying down its debts, but there is no reasonable prospect of that happening. Mr Gallois has been making noises for some months about redefining SNCF's financial relations with RFF and the state. This year the 250km extension of the line to Marseilles will put up his access charges to *euro*1.7 billion. SNCF complains that the track charges will swallow all its passenger revenues on the Marseilles run.

Mr Gallois thinks that the government should just bite the bullet and take over the debts on RFF's books, in effect writing off the infrastructure investment of building the high-speed network. In that way SNCF might win lower access charges. In practice, however, the government has asked RFF to reduce its borrowings by about half over the next ten years, and the European Commission is increasingly critical of France's support for its railways, expecting a more commercial framework and the opening of at least some lines to competition. The first customers for Marseilles will be paying about *euro*62 for an off-peak single ticket, or *euro*75 at rush-hour. That may yet turn out to be a short-lived bargain at the taxpayer's expense.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

The Internet

Off with their beards

May 31st 2001
From The Economist print edition

The freewheeling culture of the Internet could be on the way out

THROW out your lava lamp. Hide your flower-patterned iMac. For a new mood is abroad in the technology industry: the notion that in order to make money on the Internet, it may be time to abandon its free-wheeling, 1960s-inspired hippie philosophy.

“There is no revenue credibility for new services on the Internet—and that’s the fault of the west coast hippies,” said Tom Nolle of CIMI, a telecoms consultancy, in his keynote address to Vortex, a big telecoms conference that was held last month. Delegates applauded enthusiastically. Anthony Alles of Tahoe Networks, a recently launched start-up that aims to link the Internet to mobile-phone networks, has expressed similar sentiments. He complains that the greybeards who designed the Internet still insist on trying to run it like a public utility, and he suggests that they should “move to France”.

Even a few months ago, saying this sort of thing would have been unthinkable. But in the wake of the dotcom meltdown, it has become clear that oft-repeated Internet shibboleths such as “information wants to be free” may not make any business sense. Almost all of those failed dotcoms tried to find business models that were compatible with the Internet’s traditional free-for-all; but of those that are left, many are now introducing subscriptions and fees. Listening to the Internet’s purists, in other words, has finally been recognised as being bad for business.

But it is the coming convergence of the Internet with mobile telephony that threatens to do most to undermine the Internet’s free-wheeling culture. On the Internet, messaging and content are traditionally free, whereas users of mobile phones are accustomed to having to pay for their services.

Connecting mobile phones to the Internet thus provides a lucrative opportunity for mobile operators, who can act as gatekeepers, to dictate what their subscribers can gain access to, and how much they will pay for it. This sort of thing makes Internet old-timers throw up their hands in horror. But the chance to impose tolls on the Internet may prove too tempting for mobile operators to resist.

So is the hippie culture that has infused the Internet so far doomed? Vinton Cerf, the networking guru known as the “father of the Internet”, believes it will be possible to support “both the open, free information model and the for-pay model within the big tent of the Internet.” Perhaps he is right. But if it comes to a choice between profitability and the survival of the Internet’s traditional culture, it is not hard to guess which will prevail.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Face value

One Palm flapping

May 31st 2001
From The Economist print edition

Carl Yankowski is having a hard time turning Palm's promise into profits

BY RIGHTS, it should not have been this hard. Carl Yankowski, chief executive of Palm, the leading maker of handheld computers, is a former president of Sony's American operations. He is a big, dressed-in-black "gadget guy" with just the right combination of consumer-marketing experience and technology savvy to straddle the gap between computing and consumer electronics. From its start in 1996, Palm single-handedly generated the personal digital assistant (PDA) craze, succeeding where many had failed before, and it is now leading a drive into the new wireless world. Computing meets telecoms meets consumer electronics—the palmtop becomes the new desktop. And here, or so it might seem, in the right place at the right time, is Mr Yankowski.

Yet he is struggling. For all Palm's success in defining and leading a booming new industry—its operating system runs more than three-quarters of the world's PDAs, giving it an almost Microsoft-like monopoly—the company itself is in a very un-Microsoft-like financial mess. Recently, it issued a warning that its losses in the current quarter would be twice what had been expected—as much as $190m. Its sinking fortunes also scuttled a planned merger with Extended Systems, a deal that was meant to take it to new heights in the corporate market. Palm's shares have fallen by 90% over the past six months (see chart).

The company's difficulties do not all lie at the feet of Mr Yankowski—he took over only a year and a half ago, as Palm was freeing itself from 3Com, its former corporate parent and the source of its risk-averse corporate culture. But, like it or not, they are now his to solve.

The biggest problem is that Palm is having a hard time finding the right strategy. At the moment, it follows a combination of Microsoft's with Apple's that ends up weaker than either. Like Apple, it makes its own hardware and software: a line of PDAs and the famed Palm operating system (OS) that is the secret of its success. Like Microsoft, it also licenses its OS to other companies, ranging from Handspring, which was started by Palm's original founders, to Sony and several mobile-phone makers.

The downside to this is that Palm's licensees have proved all too good at making hardware. Today, a mere two years after it released its first PDA, Handspring is beating Palm in sales. And both Sony and Handspring have pushed their hardware further than Palm, introducing innovations such as expansion slots and add-on devices from phones to music players. The result is that the PDA business is quickly taking on the savage character of the PC industry, with commodity products, falling margins and cut-throat competition.

Mr Yankowski inherited most of this, and it had too much momentum for him to change it quickly or easily. If Palm stops licensing its operating system, it risks losing out to OS competitors such as Microsoft and Psion. If it stops making hardware entirely, it would take the best-known brand of PDA out of circulation.

The enthusiasm over Mr Yankowski's arrival in late 1999 was based largely on his background, which suggested that there might be a third way for the company. Aside from his Sony experience, which placed him at the heart of the best consumer-electronics firm just as it was embracing digital technology,

his career has been a virtual tour of great marketing firms: Reebok, General Electric, Pepsi, Memorex and Procter & Gamble. Starting it all was an engineering degree from MIT.

The hope was that Mr Yankowski could combine Sony's design and marketing skills with Palm's technology. His type of consumer-marketing experience can make the difference between a niche gadget and a Walkman-like hit. Which is why it is so puzzling that Palm has changed so little since his arrival.

Corporate priority

Many expected him to push the company faster into the consumer market, with brightly-coloured PDAs and extra consumer features such as MP3 and video. Instead, he has made his main priority the staid corporate market. At present, most Palms make it into the office thanks to somebody's personal expense account. Mr Yankowski's aim is to encourage IT managers to purchase them directly for employees, much as they buy PCs.

This is not a bad strategy—the corporate PDA market is about the same size as the consumer market, and both have lots of potential—but it may be a waste of Mr Yankowski's special talents. While he tries to sell his firm's strait-laced productivity tools, in black and grey, to corporate purchasing managers, his old company, Sony, is generating enviable buzz with a cool purple PDA that plays videos and has a headphone jack. Worse, the corporate market is the one in which Palm faces its toughest competition, in the form of Research in Motion's Blackberry interactive pagers, which have generated Sony-like excitement among the suits.

Palm's recent results have at last provoked Mr Yankowski into thinking more broadly. He is now in management retreats with his staff and is expected to announce a new strategy soon. But his options get more limited by the day. Palm's finances are too rocky to get into a consumer-marketing race with Sony. Nor does it have the products to justify that. The first Palms designed on Mr Yankowski's watch are now out. They do little more than add an expansion slot like the one Handspring has had for two years.

Meanwhile, the collapse of the planned merger with Extended Systems, which has had success selling to IT managers, limits the push into the corporate sector. And abandoning hardware entirely would reduce Palm to a software and services firm—hardly the place for a consumer-marketing guru. Mr Yankowski does not have much more time to find the right answer.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com BUSINESS

Pen computing

Mightier than the mouse?

May 31st 2001 | REDMOND
From The Economist print edition

Pen-driven computers are suddenly back in fashion

IS PEN computing, a promising technology that foundered in the 1990s, about to stage a comeback? Emboldened by the popularity of pen-driven handheld computers, such as the Handspring Visor, the Compaq iPaq and the troubled grand-daddy of them all, the Palm Pilot (see article), some computer makers are betting on a market for fully fledged PCs that can be operated with a stylus. IBM, Sony and others have launched innovative pen-based PCs, and Microsoft is throwing its weight behind a new range of portable "tablet" PCs, to be launched next year.

Reuters

Should Bill keep taking the tablets?

The pen-based computers of the 1990s, notably the Apple Newton and EO Personal Communicator, flopped because they were over-ambitious. The Newton's handwriting-recognition software was clever, but proved inadequate as a keyboard replacement. The EO, which was sold as a mobile fax terminal, was expensive and bulky. But where the Newton and the EO failed, the smaller Palm and its sort succeeded by making a number of compromises. Rather than trying to recognise cursive handwriting, they force users to write one letter at a time; and they are sold as companion devices to desktop PCs, rather than jacks-of-all-trades. As a result, handhelds are useful for "to do" lists and diaries, but not much use if you want to write a novel. Similarly, the latest pen-driven PCs are realistic about the limitations of pen technology.

IBM's TransNote computer, which was launched in February, is notable both for its curious shape and for its lack of handwriting-recognition software. When folded up, the TransNote resembles a portfolio. It opens to reveal a small laptop computer on one side, and what looks like an ordinary pad of paper on the other. But scribble on this paper, and your notes and drawings are captured by a digital sensor beneath the pad for transfer to the computer. The idea, says Jim Alfaro of IBM, is to appeal to users (such as students and lawyers) who like the convenience of pen and paper, but also want to be able to archive, search and e-mail their scribbles. Tellingly, IBM chose not to include handwriting-recognition features because it felt that the software is still not accurate enough for everyday use.

Sony's Vaio Slimtop computer is a sleek desktop machine with a tilting flat-panel display that supports a pressure-sensitive stylus as well as the usual keyboard and mouse. It too lacks handwriting-recognition software and is aimed at graphics professionals, who can use the stylus to manipulate illustrations on the screen directly, rather than via a mouse.

While the TransNote and the Slimtop are aimed at particular niches, Microsoft is being more ambitious. It is positioning the TabletPC as both a pen-based portable computer and a no-compromise desktop machine. Microsoft will not manufacture TabletPCs itself, but has licensed the design to several computer makers including Compaq, Sony and Toshiba. The first models are expected to go on sale next year.

It is crucial, says Bert Keely, Microsoft's TabletPC guru, to avoid taking a religious position against using a keyboard. The TabletPC can be mounted on a desk and used in conjunction with a mouse and keyboard; it can then be picked up, carried around, operated with a pen and linked to the network via a wireless connection. Special software supports cursive-handwriting recognition and other pen functions. The way to think of it, says Mr Keely, is as "a laptop that fits into more settings". Microsoft's chairman, Bill Gates, recently predicted that "all PCs will eventually be like this." Is he right?

The PC industry would like to think so, given that PC sales are slowing. Microsoft would love to see tablets take off too, since the TabletPC design uses its new Windows XP operating system. But not everybody is convinced. Alan Promisel, an analyst at IDC, a market-research firm, says that the selling-

point for TabletPCs will be that they are an unobtrusive way to take notes in meetings, compared with conventional laptops. The problem, he says, is that the cursive-handwriting recognition software, while better than that of a few years ago, is still not up to the job. The advent of large colour screens and wireless network connections make the TabletPC an attractive product. But, Mr Promisel predicts, TabletPCs will remain niche products until the handwriting recognition is sorted out.

Cursive-handwriting recognition remains the crucial hurdle that must be cleared if pen-based computers are to compete on equal terms with desktop or laptop PCs. Without it, the second coming of pen computing could prove to be as disappointing as the first.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Hedge funds

Swing, swing together

May 31st 2001 | NEW YORK
From The Economist print edition

Investment banks risk getting burned by hedge funds. Again

Get article background

INVESTING in hedge funds is hot again, but this time with a difference: many investors are buying insurance against losing money. A curious concept, you might think, for such a risky game. Yet investment banks are selling capital protection, for a price. Some financiers fear that the risks their rivals are taking in offering such protection will be unhedgeable in times of market distress. That, after all, is why portfolio insurance failed in October 1987, accelerating the markets' free-fall.

Net inflows to hedge funds totalled nearly $7 billion in the first quarter of this year, bouncing back to levels last seen before the crash of Long-Term Capital Management (LTCM) in September 1998. Most of that flow has been into equity or equity-linked funds, where the capital-protection racket is most rife.

The top Wall Street firms, such as Morgan Stanley and J.P. Morgan Chase, say they are alive to the danger, and rather disparage their second-tier rivals, among them French and German banks and insurance-company subsidiaries, for winning hedge-fund business by taking on greater risks. They would say this, wouldn't they—and these firms had to put $3.6 billion into LTCM after it was hit so hard in the Russian crisis of August 1998. It seems, whatever they say, that they are all in the game to some extent, and getting in deeper. In a market downturn, their hedge-fund positions could hurt them and amplify panic.

The majority of hedge funds are not like LTCM. They take small, well-managed bets on debt or equity trends, or on anomalies in market pricing. They do not borrow too much. And they can produce returns well above those available in share and bond indices (although they charge high fees and keep a big chunk of the profits). One reason for this is that they are not forced to run with the herd.

Which does not, however, stop the herd from running with the hedge funds. Since the LTCM debacle, the financing of hedge funds has become a far tighter game. Banks will not allow them to borrow more than three to seven times their capital, if at all. By comparison, commercial banks borrow as much as 12 times their capital, and investment banks often leverage as much as 30 times. LTCM was leveraged more than 100 times.

The banks have been reducing their own credit exposures to hedge funds by bringing in outside investors. But most investors are cautious, particularly insurance companies and pension funds. Their statutes often will not let them invest in entities of low credit standing.

So banks and investment houses have been offering notes linked to hedge-fund performance, with a guarantee that at maturity they will get back at least the capital they started with. "Principal protected notes" have become big business, and thanks to them, several billions of dollars of fresh money each month are being poured into these small—or now not so small—hedge funds. Société Générale, a French bank, says it has issued more than $3 billion of such notes, in private or public form. The fashion for pension funds or insurance companies to invest a small proportion of their portfolios in hedge funds will, if it continues, provide a wall of money. That would not in itself be a problem for the hedge funds. But it would be a problem for the banks that have offered money-back guarantees.

How can a bank afford to offer such guarantees? The simplest way is to reinsure the risk with an

insurance company. Several will oblige, including Swiss Re and Zurich Re. A more complex way is to invest a proportion of the capital in something safe, such as zero-coupon Treasury bonds, so that at the target date it yields most or all of the principal sum. The rest of the capital is invested in the hedge fund or funds, on a leveraged basis or in positions which mirror what the hedge fund is doing. If the hedge fund starts achieving spectacular returns, either positive or negative, the bank must adjust its “delta” position quickly in order to track the profit or avoid the loss.

In many agreements with hedge funds, banks can take the investment out of the fund when there is severe underperformance. But—here is the catch—hedge funds are not very liquid investments. At best they allow disinvestment once a month. Some require an investment “lock-up” for a year or more. If the bank can see all the positions in a hedge fund’s portfolio, it can guard against a downturn more quickly. But there is a potential conflict of interest if it is acting as the fund’s prime broker as well. Morgan Stanley, an investment bank, says it will not act as prime broker for a fund which it is tracking in this way. Other banks are apparently not so squeamish. Such a conflict of interest could become acute in periods of market turbulence.

Delta-hedging is a game which requires not just vigilance, but also liquid markets. In a sense, the banks have substituted the credit risk of financing hedge funds with the market risk of their underlying investments, which they believe they are better at quantifying and hedging. Many of them skip the investment in zero-coupon bonds, believing they are agile enough to create “virtual” zero-coupon structures.

But, as is often the case, the risks are getting higher and the returns lower as more firms join the fray. Moreover, with the decline in interest rates, the zero-coupon structure demands a higher proportion of the capital to protect the investment, leaving less to invest in the hedge fund itself.

Two things are likely to happen, says a risk manager close to the business. First, investors will begin to see that investing in a diversity of hedge funds, without principal protection, will provide nearly as stable returns. (Principal protection is bought at the expense of some of the hedge funds’ profits.) Second, the hedge-fund industry will become mainstream—not, as it is now, an “alternative investment strategy”. Hedge funds’ performance will then become more correlated with the rest of the market (and so perhaps will their fees).

That assumes, however, that there is no spectacular blow-up as in 1998. “People have programmed 1998 into their models: 1998 can’t happen again,” says a risk strategist at a big Wall Street firm. But with their eyes on the rear window, today’s risk managers are quite likely to miss the next big event until it hits them. Could delta-hedging of hedge-fund portfolios be it? As long as the business is hot, few on Wall Street or in the City, or those who watch over them for that matter, seem worried.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Inflation in America

The new old danger

May 31st 2001 | NEW YORK
From The Economist print edition

The markets are preparing for a dose of inflation—good or bad?

THE "reinflation play" is the latest trading strategy on Wall Street—and one that reflects a fast-disappearing faith in Alan Greenspan. As the chairman of the Federal Reserve has presided over five interest-rate cuts this year, each of 50 basis points, the reaction of the markets has turned from euphoria to nervousness. A growing number of investors fear that he may have cut too far, too fast—and they are looking for investments that will pay off if easier money results in higher inflation.

Mr Greenspan confronted the doubters in a speech on May 24th, noting "an absence of inflationary zest". Energy inflation is "probably peaking". Rising unemployment should dampen wage increases. As a result, "prices seem likely to be contained", he concluded—while pointing out, just in case, that "forecasts of the suppression or re-emergence of inflation, like all forecasts, do not have an enviable record". Quite so.

The markets were unimpressed. Some measures of inflation are less benign than Mr Greenspan's favourite, the personal consumption deflator excluding food and energy. Headline inflation in April may have reached an annual rate of 3.3%, and core inflation 2.6%. It is premature to assume a top is near in energy prices, which have soared: OPEC is aiming for a higher oil price, and the change to Democratic control in the Senate means the Bush administration is unlikely to get approval for new drilling. This week's unexpected jump in consumer confidence may mean that the economy is starting to recover sooner than had generally been expected. The dollar may weaken, leading to higher import costs. And so on.

There are at least eight different indicators that the markets are worried by inflation, reckons Jim Bianco of Bianco Research. Among them are rising commodity prices, including that ancient backstop, gold. Rising too are the shares of companies that stand to benefit from inflation—they have outperformed the S&P 500 index this year.

Most fearful of all are the fixed-income markets, which have started to react positively to good news, and negatively to bad news (the opposite of their usual behaviour), perhaps because good news reduces the chance of more Fed cuts. Since the Fed first cut rates on January 3rd, the yield on AAA-rated corporate bonds has risen by around 30 basis points. Mr Bianco says this is the only time that long-term interest rates have risen during a period in which the Fed has cut rates either five times, or by a total of 250 basis points. In similar past easings, longer-term rates have fallen, on average, by nearly 100 basis points.

Short-term interest rates have also risen since March 20th, when the Fed made the third of its five cuts. Usually, short-term rates plunge when the Fed is in easing mode. But on May 15th the short-term yield curve turned positive for the first time in 16 months, usually an indicator that the market thinks enough easing has taken place. The federal-funds futures contract is also betting that the central bank will not be able to ease much further, despite Mr Greenspan's hints to the contrary.

The gap between yields on Treasury inflation-protected securities (TIPS) and normal Treasury bonds exposed to inflation risk has widened rapidly since it hit bottom on January 2nd, the day before the Fed started easing. This is either an indicator of coming inflation or, says Stephen Roach of Morgan Stanley, a terrific buy signal for bonds. On the previous two occasions that the TIPS gap was as large as now, in January and May 2000, the inflationary scare was quickly reversed, setting off a powerful rally in the bond market. Mr Roach, one of the first Wall Street economists to give warning last year of an impending recession, reckons that the American economy will get worse before it recovers. Wall Street, he thinks, is wrong to worry about inflation risk because it is wrong to expect a sharp economic rebound.

Some cheerier Wall Streeters find comfort in the return of inflation. Christine Callies, chief investment strategist at Merrill Lynch, reckons that any general increase in prices now should be seen as "good

inflation not bad inflation". As in four recent periods when share prices rose even as inflation increased, the pick-up in prices should be welcomed as a sign that an economy that was showing worrying signs of weakness is recovering, and not of the central bank losing its grip. Good inflation? For Mr Greenspan, unlike some investors, there may be no such thing.

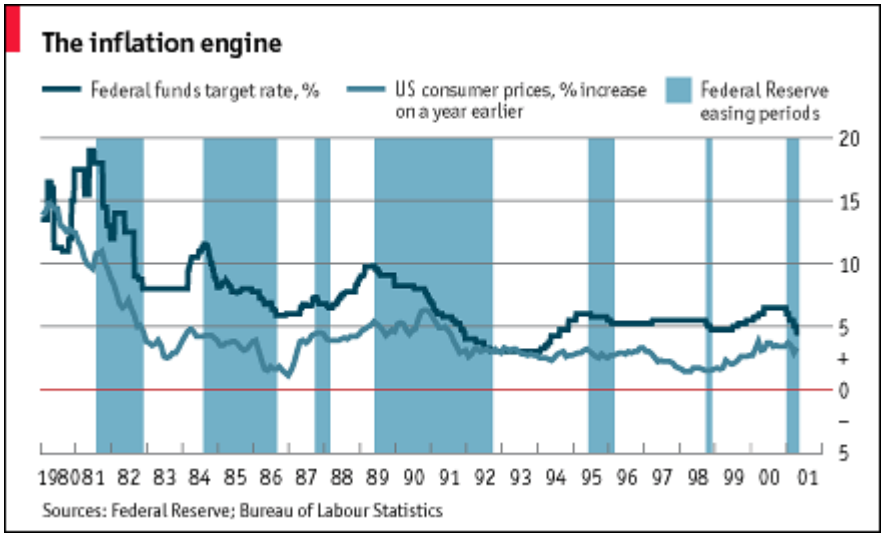
Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

The historical evidence

A trigger-happy Fed

May 31st 2001
From The Economist print edition

The Federal Reserve tends to overshoot on its way down the interest-rate ladder



RUMOURS of inflation's impending return should come as no surprise to those who know the Federal Reserve's history. Over the past two decades, prices have usually risen after periods in which the Fed loosened monetary policy. It may well overshoot this time too.

Between July 1981 and November 1982, for instance, the central bank brought the federal-funds rate down by 11 points from the high levels needed to combat the price surges of the 1970s. Inflation dropped to 2.6% in June 1983, when the last of the easings should just have begun to bite. But by March 1984, the rate had risen back to 4.8%.

Between August 1984 and August 1986, the Fed lowered interest rates by 5.7 points. Inflation had already slumped to 1.6% by April 1986, but within a year it had picked up to 3.9%. Pick-ups in inflation followed on the heels of smaller easings in 1987-88, 1995-96 and 1998. Only one loosening, the cut of 6.1 points between June 1989 and September 1992, resulted in stable prices.

Economists often finger the Fed as the engine of downturns, since no events coincide with recessions more than monetary tightenings. It is cold comfort that the central bank is capable of overshooting in the other direction too.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Economics focus

Voting for welfare

May 31st 2001
From The Economist print edition

Europe's welfare state needs reforming, most economists agree. Just one problem: Europe's citizens like it as it is

THE welfare model of Europe is known to be unsustainable in at least one respect. As the continent's populations age, the cost of providing generous state pensions under the current rules will prove insupportable: big increases in tax rates will be needed to balance the books, bigger than most politicians think voters will accept. And another characteristically European problem is also blamed on the welfare state: chronically high unemployment. Most economists attribute this, at least in part, to a combination of generous unemployment benefits and strict employment-protection laws. Europe's leaders call on each other from time to time to do something drastic about both issues, and then do nothing.

The persistence of Europe's defective welfare model is not as surprising as some economists think. The welfare state is popular—not just with narrow sections of the electorate, able somehow to hold their countries to ransom, but with solid majorities of voters. It is popular even though voters know, or say they know, that their pension systems are heading for insolvency. These are among the findings of a new opinion-polling exercise carried out by Tito Boeri, Axel Börsch-Supan and Guido Tabellini, and reported in the latest issue of *Economic Policy**.

Most polls on questions such as these are useless. Ask people if they prefer low taxes to high taxes and a comfortable majority will say yes. Ask them whether they prefer big pensions or small pensions and, after only a few moments' thought, most will say, "Big pensions". If polls are to elicit useful information about preferences, such questions have to be posed as trade-offs, so that people are asked, in effect, "how much is such and such a benefit worth to you?"

The economists who worked on this new study asked their questions in this form. They gathered further information about their respondents, so that preferences could be correlated with attributes such as age and union membership. And, for good measure, they polled lots of voters on a consistent basis in each of several countries—specifically, France, Germany, Italy and Spain.

All this has enabled them to come to some interestingly fine-grained conclusions, going well beyond the straightforward finding that majorities are happy with the system as it is (that is, neither want it scaled back in return for reduced taxes and contributions, nor increased at the cost of higher taxes and contributions). One such finding, for example, confirms a plausible but hitherto unverified supposition. Employment-protection laws concentrate the risk of unemployment in "outsider" groups such as workers on temporary contracts, the currently unemployed, and so on: you would therefore expect tighter laws to decrease the demand for unemployment benefits among insiders with eligible jobs and increase it among outsiders. That is what the study finds. Insiders covered by strong laws are less willing to pay for benefits. On the other hand, countries with strong laws and (as you might therefore expect) more limited benefit coverage have bigger coalitions of outsiders who want extensions to benefits and are willing to pay for them.

This leads on to policy implications. It turns out that extensions to the coverage of unemployment benefits could often be self-financing: would-be beneficiaries are willing to pay more than an actuarially fair contribution. Also, since benefits and labour laws both reduce insecurity, but labour laws are especially bad for efficiency, governments might try to ease regulation while increasing benefits.

The authors' numbers suggest this would be politically feasible, especially in Italy and Spain; and, given the terms of the feasible trade-off, this bargain would be economically advantageous as well. In France and Germany, where benefits are already very generous, a different reform trade-off could be pursued: extend benefit coverage to more workers with short contribution records, but reduce the maximum duration of benefits for those already covered. Again, that would command support, and be economically

helpful as well (because long-term unemployment is strongly associated with long-duration benefits).

On pensions, big majorities in France, Germany and Italy expect a financial crisis bad enough to cut their benefits. (Only two-fifths of the Spanish were so gloomy.) Majorities in every country except France would like to opt out—that is, pay smaller contributions and get smaller benefits in return—but only if this were accompanied by a mandatory savings plan. People were less keen on opting out if the opted-out could choose for themselves whether to save their reduction in contributions or not.

However, this kind of reform involves a transition burden: today's workers, whether opted in or out, must carry the burden of paying for today's pensioners. When this burden is added to the costs to be faced by those opting out, the popularity of opting out falls, unsurprisingly. But the average acceptable transition burden turns out to match almost exactly the predicted transition burden of current plans for partial privatisation of the systems. In short, radical state-pension reform, carefully presented, need not be the political non-starter it is often assumed to be.

Believers in small government, disheartened though they may be by the overall findings, can take heart from that.

---

*"Welfare State Reform: A Survey of What Europeans Want." Available at http://www.economic–policy.org/

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Caribbean stock exchanges

Island-hopping

May 31st 2001 | TRINIDAD
From The Economist print edition

Eight islands want a common stock exchange. Why not all of them?

BETTER known for bananas and beaches than for high finance, eight little islands in the eastern Caribbean plan to open a shared stock exchange by August. Based in St Kitts, the headquarters of the Eastern Caribbean Central Bank, the new Eastern Caribbean Securities Exchange will be a model of international integration, with all-electronic trading and a T+1 settlement system. Any problems? Between them, the islands have only 28 public companies, and not all want a listing.

This will be the fifth tiny stock exchange in the Caribbean. Jamaica's opened in 1969, followed by markets in Trinidad, Barbados and (last year) the Bahamas. Guyana, with eight public companies, also wants its own exchange. The four existing bourses have a total of 100-plus listed companies, and a market capitalisation of just over $10 billion. Trading is thin. In Trinidad, trading volume fell from 12% of market capitalisation in 1995 to 3% in 2000. Barbados has had two days this year with no trades at all.

The first Caribbean stock exchanges were set up when post-independence politicians dreamed of self-contained island economies. Foreign investment was barely tolerated, and exchange controls blocked the outward flow of home-grown savings. But many islands have since abolished or weakened exchange controls. Cable TV and the Internet encourage wealthier citizens to invest in New York. On the local markets, new listings are rare.

The ECSE is already set up for inter-island trading and could expand. But in April a private-sector lobby group, the Caribbean Association of Industry and Commerce, launched plans for a single regional exchange: Caress (for Caribbean Regional Exchange for Stocks & Securities). Such an exchange was first proposed in 1988, by Jamaica's former prime minister, Michael Manley. Why did it not arise?

Most regional currencies are pegged to the American dollar. Investors with stronger currencies are nervous about putting cash into Jamaican or Guyana dollars, which drift gently downwards. And the smaller islands retain exchange controls. Nine regional companies cross-list their shares on two or three exchanges, but without a single trading system they have few takers outside their home country. A single Caribbean exchange would still be small; but it might have better growth potential than the ECSE.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Banking in Brazil

Down to the roots

May 31st 2001 | SAO PAULO
From The Economist print edition

Brazil's banks are growing fast—by turning their hands to banking

IN THE days of roaring inflation, high interest rates and reckless public spending, Brazil's banks never tried hard to attract customers: they made easier profits investing in government bonds. But, since the 1994 *real* plan, interest rates have fallen and the government has brought borrowing under control. Analysts predicted that banks would, sooner or later, have to return to their core business—and, in particular, to take more interest in the 80% of Brazilians who have no bank account.

AP

Drumming up new business

That time has now come. With the economy enjoying brisk growth with falling unemployment, Brazil's banks have been expanding fast, opening new branches and spending heavily on advertising to seek new customers. In the 11 months since the central bank began compiling comprehensive figures, the volume of loans to individuals has grown by 60% to 61 billion *reais* ($26.1 billion). The three biggest private-sector banks, Bradesco, Itau and Unibanco, have just announced bumper quarterly profits, as has the government-owned Banco do Brasil.

The boom has some way to go, reckons Paulo Feldmann of Ernst & Young, a consultancy. Much of the recent growth came from selling more financial products to better-off Brazilians who already have accounts. But the banks are also taking an interest in those earning as little as 500 *reais* a month. Mr Feldmann reckons that perhaps 10m of these will open their first accounts by the end of 2003. Such people are often shy of entering banks; to draw them in, they are being offered a credit card—a status symbol available only to the rich until recently—if they open a current account.

The big private-sector banks have also been buying former public banks, with their (badly served) poorer customers. For richer Brazilian clients, they are having to compete with foreign banks such as BSCH and BBVA of Spain and HSBC of Britain, and with the two big state-owned retail banks, Banco do Brasil and Caixa Economica Federal. Antonio Luiz da Silva, Banco do Brasil's retail director, says he is opening dozens of branches this year in the Rio-Sao Paulo region, the richest part of Brazil, and expects to gain 1m customers.

But can the banks make money out of people who have so little of it, especially given Brazil's high levels of bad debt? Mr Feldmann says that poor Brazilians tend to be more reliable payers than the rich, because they have a greater fear of being registered as defaulters. Nevertheless, says Michael Geoghegan, head of HSBC in Brazil, these banks will have to cut costs sharply to turn a profit from poorer clients. HSBC has cut 5,000 jobs in Brazil since buying Banco Bamerindus in 1997.

Other banks are making cuts too. Lay-offs at BSCH may reach 8,500 this year, in order to justify the whopping $5 billion it has spent on Banespa, a former state bank. Sacking staff while expecting those who remain to deal with more customers has, unsurprisingly, led to strikes at Banespa. Bradesco has had stoppages too. With staff numbers falling as client numbers boom, the banks will have to persuade their newer, poorer customers to do most of their business using ATMs. Banco do Brasil's Mr Silva is moving some staff in front of the counter to coax technology-shy clients to try the machines.

There is also a search on for other distribution channels. The national lottery's 8,500 outlets have been turned by Caixa Economica Federal into mini bank branches. The government is inviting public and private banks to distribute their products through its 12,000 post offices. Several banks are experimenting with bank terminals installed in shops.

The idea is that millions of potential new clients might be sold other financial products. Banks' attempts elsewhere to become financial supermarkets have had mixed results. But Tomas Awad of BBA, an investment bank, says that Brazilians react positively to being able to buy all their financial products—from pensions to car insurance—from the same source: the banks already have a sizeable share of the insurance market, which has much scope to grow, as it accounts for only 2% of GDP compared with a world average of 7.5%.

Brazil's banks complain that they are hampered by excessive regulation—for instance, by a rule that they must lend 65% of their savings deposits as housing mortgages. Compared with banks in the rest of Latin America they are well-capitalised (though the public ones are awaiting a recapitalisation by the government), profitable and technically advanced. So they may keep expanding.

But while Mr Awad reckons that Brazil is not yet experiencing a credit "bubble", there are some clouds on the horizon. The proportion of personal-loan repayments that are at least 15 days late has risen from 8% to 11% since last May. High margins have made such arrears bearable, but as new, creditworthy customers get harder to find, margins will narrow, and higher default rates begin to hurt. For these reasons, HSBC's Mr Geoghegan says he has recently tightened his bank's credit requirements.

Worse, Brazil's economy may be about to suffer a California-style electric shock: the country is set to suffer an energy crisis, with widespread power cuts forecast in the next few months. This may force banks to close for part of the day. If it is as bad as the direst predictions, the electricity crisis could reverse the recent falls in unemployment. Many of the banks' newer, poorer customers may then find it hard to repay their loans, however keen they are.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Japan's economy

Chronic sickness

May 31st 2001 | TOKYO
From The Economist print edition

After a decade of sluggish growth, what is the right medicine for Japan?

NOBODY any longer disputes that the patient is seriously ill. Japan in recent years has exhibited the first bad case of deflation in a big economy since the 1930s. It has the highest ratio of public debt to GDP of any big economy in peacetime, though the lowest long-term rates on record somewhat temper the debt burden. Over the past decade, Japan has averaged annual growth of only just above 1%, the worst ten-year performance of any big economy in the past half-century. And now, a mere two years after it crawled out of one recession, Japan seems to have slipped back into another. What will it take to restore this patient to health?

Deceptively, figures for GDP in the first quarter of the year, to be published in early June, are likely to show reasonable growth, if only because a new law on recycling old electrical products has encouraged households to accelerate their purchases. More telling, industrial production has plunged in the past four months by 20% at an annual rate and unemployment has risen to a near record of 4.8% in April. Plummeting American investment in information technology has hit Japanese exporters hard. In the second and third quarters of this year, GDP will probably shrink. Deflation is likely to persist into 2002.

The country's new prime minister, Junichiro Koizumi, offers hope—he is Japan's Margaret Thatcher, in the eyes of some. He wants to shift from the demand-side stimulus pursued so far to structural reform. Mr Koizumi has set three priorities: cleaning up the banks, reducing the government's huge budget deficit and deregulating the economy. A lot is riding on Mr Koizumi, yet his ambitions will be resisted by many within his own Liberal Democratic Party. But suppose he gets his way. Is this the right economic medicine?

There is a lively debate between those who applaud Mr Koizumi's microeconomic reforms and those who urge more macroeconomic stimulus. The first camp argues that the economy will not revive without structural reforms that lift Japan's productivity growth. Besides, the argument goes, there is no room for more monetary and fiscal expansion; and what there has already been has allowed inefficient firms to survive at the cost of faster economic growth. Most economists reckon that Japan's long-term potential growth rate has fallen to 1-1.5%, down from 4% in the 1980s. Structural reformers also argue that, until banks' bad loans are written off, they will be unable to increase lending to support a recovery.

The second camp, which includes two vocal American economists, Jeffrey Sachs and Paul Krugman, has it that Japan's slow growth over the past decade is due not to low productivity and hence insufficient supply, but to inadequate demand. Structural reforms aimed at improving the supply side of the economy may even widen the output gap (already 5% of GDP) and worsen deflation. If banks are forced to write off bad loans and foreclose on debtor firms, this will lead to rising bankruptcies and unemployment. This camp's prescription is massive monetary easing and a depreciation of the yen.

How could Japan need a cheaper yen, when it already has a huge trade surplus? Andrew Smithers, a London-based economist, argues that Japan's biggest problem is a large net surplus of saving, a result of its demographic structure. An ageing population wants to save more than the country's firms can profitably invest. At present, this gap is matched by a total public-sector deficit (government dissaving) of 7% of GDP, and a current-account surplus of 3% of GDP. In the long run, the budget deficit is not sustainable. So if Japan is to absorb its excess saving and to have a sustainable recovery, it needs, says Mr Smithers, to run an even bigger current-account surplus. A weaker yen will also push up prices and halt deflation, so helping to solve Japan's second big problem: excessive debt. Goldman Sachs estimates that total public and private debt amounts to five times GDP. As long as deflation persists, the real debt burden will rise.

Not one or the other, but both

Yet the truth is that neither structural reforms nor macroeconomic stimulus will, on their own, be enough to cure Japan's ills of deflation and slow productivity growth. By itself, restructuring probably will intensify deflation in the short run, although in the long run deregulation should boost jobs and business. Mr Koizumi is naive in saying that, should his structural reforms cause the economy to contract, "that's just too bad". Easier monetary policy needs to accompany debt write-offs if fresh bad loans are to be avoided. Figures this week suggest that new bad loans are appearing almost as fast as banks have written off their old ones.

By the same token, monetary or fiscal expansion alone will fail to deliver sustainable growth, because they would reduce the pressure for structural reform. And Mr Smithers is wrong to take Japan's structural savings surplus as given. Japan's high saving is due not just to an ageing population, but also to a return on capital that is about half that in America. This low return forces households to save more in order to build their desired nest-egg for retirement. Corporate restructuring would shift resources to more productive uses and thereby raise the return on capital. Households might then save less and spend more.

Structural reform and macroeconomic stimulus must proceed hand in hand. With public debt equivalent to more than 130% of GDP, the scope for further fiscal stimulus is limited. Even so, Mr Koizumi's intention of making cuts in the budget deficit a top priority is ill-considered: to cut public spending or increase taxes at the same time as writing off bad loans would leave the economy winded. Fiscal consolidation should therefore wait until the economy is growing again.

Yet even if the budget deficit is held at its present level for a few more years, the mix of spending and taxes could be changed to provide a more effective stimulus. Wasteful public works could be cut to make room for lower income-tax rates or a more generous unemployment safety-net, to cushion the impact of restructuring.

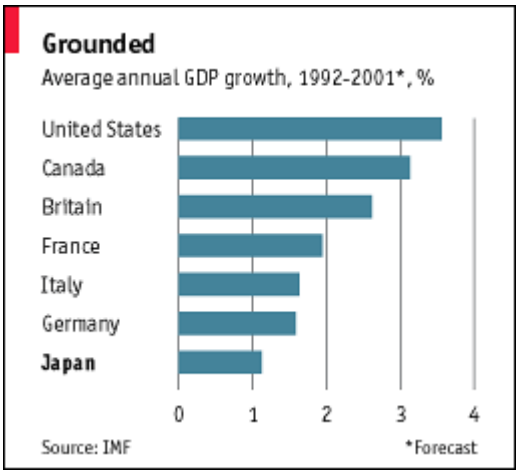
Monetary madness

If fiscal policy cannot be significantly loosened, that leaves monetary policy. Nominal short-term interest rates are zero, but real interest rates remain high. The yen's trade-weighted exchange rate is also quite high by historical standards, a sign that monetary policy is tight.

Recognising its error in raising interest rates last August, the Bank of Japan announced a new framework for monetary policy in March. This returned interest rates to zero, but with three important twists. First, it is now targeting the level of banks' reserves (their deposits at the central bank) instead of interest rates. The Bank of Japan has to inject liquidity by offering to buy treasury bills and other securities from banks, so as to achieve its target. Second, the bank says it will stick with this policy until the core inflation rate (excluding fresh foods) rises above zero. And third, the bank has said it may, if necessary, increase its purchases of long-term government bonds to meet its goal.

This is bold stuff. Yet so far there has been little genuine monetary loosening. The increase in reserves is too small, and the bank has failed even to meet this target several times over the past month because, with lending declining, banks do not need extra cash. Still, this is a more flexible framework within which the bank could, if it chose, pursue more aggressive monetary easing.

Yet the Bank of Japan continues to insist that it has done all it can. It is true that the bank cannot cut interest rates further. On the other hand, "quantitative monetary expansion"—printing money by buying bonds directly from the government—can still work at zero interest rates, through its impact in raising inflationary expectations, in pushing the yen lower, or in lifting the prices of assets such as equities.



One way to affect expectations about inflation would be to set a formal inflation target, perhaps 0-2%. If this helped to convince firms and households that the bank would not allow prices to keep falling, it would lower real interest rates. Japan's measure of consumer-price inflation (currently minus 0.4%), is thought to overstate inflation; the true rate is probably closer to minus 2%. This August the index will be revised to include new goods and services, such as mobile-phone charges and personal computers, which have been falling sharply in price. By revealing a faster pace of deflation, it may force the central bank to do more.

The most effective channel through which quantitative easing would work is the exchange rate. Printing lots of money should push down the yen and help to create inflation and to lift exports. Tadashi Nakamae, an independent Japanese economist, estimates that the yen's purchasing-power parity is around ¥160 to the dollar. So long as the exchange rate remains at around ¥120, deflationary pressure will persist, as the yen moves towards this purchasing-power parity through a decline in prices rather than a fall in the exchange rate.

The snag is that a falling yen is likely to meet with complaints from Japan's trade partners. But America might accept a weaker yen were it combined with serious structural reforms. Japan's Asian neighbours are also concerned: a fall in the yen helped to trigger their currency crises in 1997-98. But most Asian currencies now float, so they can slide down with the yen. China, whose currency is still pegged to the dollar, has already complained that the fall in the yen over the past year has hurt its economy. However, in the longer term the strength of Japan's economy is more important for the region than the strength of the yen.

Further monetary easing is essential to halt deflation. So why has the Bank of Japan resisted it? First, because it worries that quantitative easing might be ineffective, thereby undermining its credibility. And second, it frets that a massive monetisation of debt might create runaway inflation. These worries underscore the bank's muddleheadedness. What credibility does it still have, after years of deflation? And how can it argue that an expansionary policy will not work, while at the same time worrying about hyperinflation?

The bank also worries about something more substantial. If it buys government bonds, and if this increases inflationary expectations (the point of the policy), bond yields could rise. This would reduce the value of the huge amount of bonds held by banks, further damaging their balance sheets. But this is only half the picture: if it succeeded in ending deflation, the Bank of Japan would help to reduce banks' losses on their loan portfolios, which are bigger than those on their bond portfolios.

The last, but probably most important reason for the Bank of Japan's stubbornness is that it is unwilling to stimulate the economy until the government cleans up the banking system and forces firms to restructure. The bank believes that inflation would erode firms' debts and so ease the pressure to restructure. It is true that, without reform, productivity growth will remain low, but by imposing deflation for longer than necessary across the whole economy, the bank is playing a dangerous game. Its mandate does not—and should not—include structural reform.

The main responsibility of any central bank is to promote price stability. Allowing deflation is a greater sin than allowing inflation. But even if the central bank sees sense, there will be no painless cure for Japan. If structural reforms are not implemented, the latest recession may be mild, but, according to Tetsufumi Yamakawa, an economist at Goldman Sachs, long-term potential growth may decline to only 0.6% a year

by 2009, as productivity growth stalls and the labour force shrinks. If Mr Koizumi pushes through reforms, then, even with monetary easing, the recession may be deeper. But after that, estimates Mr Yamakawa, Japan's potential growth rate could increase to 2-3% within a decade.

Such figures illustrate how expensive has been the perpetual delay of reform. Though structural reform is deflationary in the short term, it is still necessary. The Japanese patient needs both structural reform and aggressive monetary stimulus, and it needs them now.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Thailand's central-bank war

Governor's forced exit

May 31st 2001 | BANGKOK
From The Economist print edition

The central-bank governor succumbs to a prime minister's wrath

GOVERNMENTS everywhere, when faced with a slump, complain about tight money and blame the central bank. But Thailand's prime minister, Thaksin Shinawatra, made the opposite complaint. He urged the central bank to raise interest rates and shore up the currency. On May 29th, having lost the battle of rhetoric, he sacked the bank's governor, Chatu Mongol Sonakul. By subordinating the central bank to his wishes, Mr Thaksin has given investors another reason to worry. Some were already wondering about the telecoms tycoon's business interests, and his equivocal attitude to privatisation and foreign investment. They also harboured doubts about his scheme for buying bad debts from troubled banks. Why sack the governor?

Thaksin 1, Chatu Mongol 0

Mr Thaksin argues that low interest rates are causing excessive capital outflows and putting downward pressure on the currency, the baht. Moreover, he says, a higher interest rate on deposits would boost domestic demand, by putting more money into savers' pockets.

But many analysts doubt whether a low baht and capital outflows are all that bad. Exports will anyway continue to suffer from the global downturn. And, after the 1997-98 crisis, Thailand's ability to run current-account surpluses and pay down foreign debt has been a rare source of comfort. As a result, several independent economists backed Mr Chatu Mongol's low interest-rate policy. So did the IMF.

Investors will be looking for more than just higher rates. The central bank had also been trying to tighten lending standards. Now Mr Thaksin, who is keen to get the banks to lend more, has replaced Mr Chatu Mongol with Pridiyathorn Devakula, an altogether more loyal fellow.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Patterns in financial markets

Predicting the unpredictable

May 31st 2001
From The Economist print edition

Some physicists think they can see into the future of markets

STOCKMARKET crashes can be like buses: you wait ages for one to come along, then three arrive at once. That has not stopped people from trying to understand why they happen, of course. But such understanding is handicapped by two things. The first is that markets are complex systems that are hard to analyse. The second is a widespread assumption that, over three centuries of stockmarket trading as we know it, any patterns that do predict the future will already have been identified and "arbitraged" out of existence by people taking advantage of them.

David Lamper and his colleagues at Oxford University disagree. As physicists and mathematicians, they frequently find themselves dealing with complex natural systems, and in a paper submitted to *Physical Review Letters*, they apply that experience to the artificial world of market mechanisms. They suggest that price patterns do exist that have not been arbitraged out. These patterns are created by the collective actions of market traders themselves—and could be used to predict sudden falls in a market.

Dr Lamper's work starts from the observation that extreme price movements in financial markets happen far more often than would be expected by chance. Presumably, therefore, there is some reason behind them. To explore what that might be, he and his colleagues built a computer model which attempts to emulate market behaviour by running a large number of software "agents" at the same time. These agents "trade" with each other according to certain strategies. (Similar trading strategies are used in the real world to carry out automatic share-dealing.)

Each agent has the same information about the past, and is fed new price data at regular intervals. But, rather like human traders, agents differ from one another in how they interpret this information. Some, for example, will look at a past pattern of rising prices, and assume that the market will continue to skyrocket. Such bulls will want to buy. Other agents will consider a rising market to present a good opportunity to sell. Still others will want to buy in a falling market that has been rising until recently. And so on.

The resulting computer-based market produces price features that are statistically similar to those of a real one, which suggests that the team's assumptions about how traders work are accurate. Unlike a real market, though, a computer market can be run backwards—that is, it can be fed a set of market data and told to work out what trading strategies are likely to have produced them. If the strategies employed before a sudden downturn are analysed, the result is intriguing: the agents have generally come to agree with one another about the best way to trade.

Although standard financial-market theory assumes that it is impossible to tell anything about the future direction of a market by looking at what has happened in the past—so that markets follow a "random walk"—most investors are seeking to do just that. When both real market data and random simulations of such data are put before traders, they claim to see patterns. This is no surprise. People see patterns, where there are none, all the time—in clouds, in lotteries, in mountains on the surface of Mars, and even in root vegetables. Predicting a number in a lottery based on such a spurious pattern cannot, of course, have any effect on whether that number is actually drawn. But the same is not necessarily true of the stockmarket. When many traders think they see the same pattern, they may respond in the same way. They may thus, collectively, create a real pattern.

Lemmings over the cliff

And not only real, but unstable. For, paradoxically, the more orderly a market appears, the less stable it is. (Think of dominoes up-ended on a table. If they are distributed at random, knocking one over causes little damage. If they are in a line, the whole lot will come down.)

It is the changes in strategy that lead to this orderly instability which the researchers say they can detect. When their system finds many traders crowding into one type of strategy, they know that a large downward change may be imminent. The super-strategy to beat this is obviously to sell first or even, for the brave, to go short.

So much for theory. The question is: are the researchers rich yet? Well, no. But the Oxford model has been tested against the real world, and it looks as though it may work surprisingly well.

The first test was against minute-by-minute historical data from a foreign-exchange market: a London bank's dollar-yen market between 1990 and 1999. The model detected enough selling and buying opportunities during this nine-year period to yield a 380% profit.

Having tried out the principle in the relative simplicity of a currency market, Dr Lamper is now taking on Nasdaq, the tech-heavy stockmarket whose tumble in April 2000 signalled the end of the dotcom boom. Running Nasdaq data through the Oxford model suggests that there was, indeed, a period of increased predictability in the six months before April 2000, compared with the months before that.

None of which means that the model will work for the future, any more than many previous such efforts. Being canny, the researchers are anyway keeping details of the algorithm they use to generate their results under wraps until the patent they have applied for is locked up. Nor are they too worried if the details of their super-strategy leak out, since they think they could detect its use in the market. That would allow them to play a "super-super-strategy" that made use of the knowledge. On that, they are keeping super-quiet.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Urban geography

Getting off the ground

May 31st 2001 | BOSTON
From The Economist print edition

Satellite imaging is helping to classify patterns of urban growth

LIKE a good Impressionist painting, a city often requires a bit of distance before its viewer can get a feel for the whole picture. Terra, the newest earth-science spacecraft launched by NASA, America's space agency, can provide 700km-worth of distance; and William Stefanov, a geologist at Arizona State University, is using this to develop a better understanding of how people create their cities. At this week's meeting of the American Geophysical Union, in Boston, Dr Stefanov explained how he used data from a satellite-borne instrument called ASTER (Advanced Spaceborne Thermal Emission and Reflection radiometer) to study 12 cities and to classify their growth patterns.

Urban planners have long known that cities have different characteristics, but the view from space makes assessing those characteristics faster and more accurate. Dr Stefanov and his colleagues (or, rather, their computers) looked for the boundaries between densely developed areas, which reflect a lot of light because of all the edges and flat surfaces that people like to create, and those with more vegetation, which appear dark by comparison, as nature prefers curves.

By focusing on the edges separating dark from light areas, the researchers classified their dozen cities into three types. Six of them, Baghdad, Baltimore, Istanbul, Lisbon, Puebla and Vancouver, are "centralised": most of their development is concentrated around a "downtown" area, and there is a gradual fading away from this with distance. Three, Albuquerque, Johannesburg and Phoenix, were "non-centralised": developed more or less evenly over the entire area, but with an abrupt edge. The other three, Chongqing, Madrid and Riyadh, were a mixture of the two types.

Other methods of measuring a city's composition and growth are less precise and more time-consuming than Dr Stefanov's. They usually involve a combination of aerial photography, ground measurements and door-to-door canvassing. Because that takes so long, it cannot be done frequently. The data from ASTER provide a relatively simple and much faster alternative.

Ultimately, the team plans to study 100 cities over six years, to try to work out why different cities grow in the way they do. The hope is to tease out the relative contributions to the process of geography, political history, climate, social structure and economics. Working with local experts in each city should provide some answers—and a better idea of how each Impressionistic dot makes up a part of the whole.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Computer displays

Lightening up

May 31st 2001 | NEW YORK
From The Economist print edition

Organic light-emitting diodes make better display units

PEOPLE in the computer business often fret about growing organically. Now they might start thinking seriously about glowing organically—for several computer-display makers say that screens using organic light-emitting diodes (OLEDs) are ready to enter the market. Barry Young of DisplaySearch, a market-research firm based in Austin, Texas, claims that 30 firms have announced plans to produce OLED displays. Next week, at the annual meeting of the Society for Information Display in San Jose, California, several manufacturers will show off the latest gizmos employing this technology.

The demand for lightweight, colourful, power-efficient displays for portable electronic devices such as mobile telephones and personal digital assistants has sent manufacturers searching for alternatives to liquid-crystal displays. LCD screens are expensive to make and run. Because liquid crystals cannot emit light, an LCD must include a separate light source. This adds bulk, as well as cost, to a display. And to create red, green and blue, the three primary colours from which all others can be compounded, an LCD has to use filters that tinge the white light produced by this source. But these filters also absorb two-thirds of that light, so wasting that proportion of the display's power. An OLED, by contrast, emits its own light—eliminating the need for a separate light source and requiring only about a third as much power as an LCD.

The device consists of a sandwich of organic compounds (complex carbon-based molecules) that emits light at a particular wavelength (and so a particular colour) when stimulated by an electric current. Unlike LCDs, OLEDs are simple to make. The organic molecules in question can be vaporised and condensed in a thin layer on to the appropriate surface. When scaled up, the process should cost only half as much as manufacturing an LCD. And the frequency of the emitted light can be altered by doping the emitting molecules with appropriate dyes.

OLEDs have other advantages. Since the current controlling an OLED can rapidly be "toggled" on and off, individual picture elements (pixels) on a screen can change their appearance fast enough to handle a stream of video or web images without leaving irritating after-images on the screen. Also, the charge controlling each pixel is insulated from that of its neighbours, so pixels do not interfere with one another. OLED screens therefore offer high contrast and resolution. Moreover, OLEDs are so-called Lambertian emitters: each diode radiates light uniformly, in a broad cone, so that a slight movement of the eye does not alter the image perceived by the viewer. In other words, it is easy to look at an OLED display from the side.

Eyes on the prize

All of these features make OLEDs well suited for use in portable devices. The immediate prize is the market for screens for 3G mobile telephones. Many firms are beginning with small devices appropriate to these. In its Timeport line of telephones, Motorola has already incorporated an OLED display made by Pioneer Electronics of Japan. A firm called eMagin, of Hopewell Junction, New York, is also trying to develop tiny OLED screens, but with an eye to the market for Internet devices and handheld computers.

In collaboration with IBM, eMagin recently created a prototype OLED display for a "wearable" computer. At next week's conference, James Sanford and Eugene Schlig of IBM's Thomas J. Watson Research Centre in White Plains, New York, will present the technical details of this computer, which can be worn on the wrist, like a watch. It uses eMagin's tiny OLED screen, which is just over an inch (2.5cm) across. The screen is wired on to a silicon chip that controls each pixel individually. It contains about four times as many pixels as a standard Palm Pilot in a fraction of the area. During ordinary operation, the display consumes much less power than would an equivalent LCD.

Recently, eMagin began shipping its full-colour OLED microdisplay to equipment developers for them to play with. This screen, which can display video and Internet images, is less than an inch along its diagonal—small and light enough to sit in a headset. When positioned a few centimetres from the eye and viewed through a lens, the tiny display gives the viewer the illusion of looking at a 19-inch screen suspended in the air. By wiring a pocket PC to the headset, a user could have the experience of using a desktop computer without having to haul around a heavy screen and battery pack. Gary Jones, chief executive of eMagin, says that the headset and lens system would cost only a quarter of the monitor that it mimics.

Other firms have visions of larger OLED screens. Engineers from Sony will exhibit a prototype that is, at 13 inches in diagonal, the world's biggest. Such a display could eventually be used in laptops, or in place of television screens. By 2003, Sony intends to start selling 20-30-inch OLED television screens. Yih Chuang, an engineer from Ritek Display Technology, a Taiwanese firm, estimates that OLED screens could eventually grow to be up to 100 inches in diagonal length. That would certainly trip the light fantastic.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Pest control

A dynamite idea

May 31st 2001
From The Economist print edition

Diatomaceous earth may soon protect tropical crops against insects

IT IS a long time since diatomaceous earth was used only by fullers to remove the grease from wool. Its most famous job was probably as the inert agent into which Alfred Nobel absorbed nitroglycerine to make dynamite. But the mineral, which acquired its name because it is composed of the skeletons of minuscule dead plants called diatoms, may be about to enjoy another, less explosive, career as an alternative to insecticides in poor countries.

Traditionally, the war between pests and agriculture is played out in the field, with the farmer, spray-gun in hand (or in tractor or aeroplane), doing battle with locusts, beetles and moths. In many countries, however, more grain is lost to pests after harvest than before it. These pests, too, may be attacked chemically, but that can be bad for the health of the ultimate consumer, for the environment, and for the pocket of the warehouse owner who has to pay for the insecticide. That is where diatomaceous earth comes in.

Insects are a miracle of water conservation. A drop of water the size of a weevil would evaporate rapidly. To survive on land, therefore, insects have to be waterproof—not to keep water out but to keep it in. Most achieve this by having waxy coatings on their cuticles.

The diatom skeletons of which the mineral is composed are able to soak up huge quantities of oily materials such as lanolin and nitroglycerine, in the same way that a sponge soaks up water. Cuticle wax is a solid oil, and is just as susceptible to the diatoms' charms as any other oily substance. Deprived of their waxy coats, the victims die rapidly of dehydration.

The idea has proved effective in some rich-world grain silos, but Tanya Stathers, of Greenwich University in England, wanted to see if it would work in the smaller-scale and rather different conditions of storage found in the tropics. In collaboration with Zimbabwe's Institute for Agricultural Engineering, she tested diatomaceous earth against a common organophosphate pesticide in three of Zimbabwe's regions, and on three crops: sorghum, maize and cowpeas.

The results of the trials, which began in 1998, are encouraging. Commercial preparations of diatomaceous earth did as well as the organophosphate in all cases bar one (a beetle called the lesser grain borer in sorghum). Crops protected in this way were also rated more highly for appearance and taste than those protected by insecticide, and commanded higher prices.

Diatomaceous earth is a widespread mineral. Although the commercial preparations employed in the trials are no cheaper than imported organophosphates, a source of the mineral has recently been identified in Zimbabwe. Mined locally, it should be significantly cheaper. And lest any potential consumer should worry about grinding his teeth on food laced with the stuff, only one part in 1,000 needs to be added to achieve protection. Besides, it is used as an ingredient in baby food—a role normally discouraged for organophosphates.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Short stories

Brief encounters

May 31st 2001
From The Economist print edition

Less is more in these four outstanding new collections

FOR sustained intensity these days, short-story collections often succeed more consistently than new full-length novels, a stack of which would surely have yielded fewer volumes of distinction than the one from which these four fine collections were taken. Perhaps the short-story collection is specially suited to catching the jangled, jump-cut nature of contemporary life—achieving a kind of cohesion by way of adjacency, as single snapshots of strangers flash past like faces on a train.

Peter Ho Davies was born to Welsh and Chinese parents, and lives in England and the American mid-west. Yet his cosmopolitan background, far from pushing him to write for a niche market of Welsh-Chinese-American Britons, has broadened his range and compassion.

Some characters in "Equal Love" share the author's fractured identity, quintessentially in "How to Be an Expatriate". A story written largely in the second-person imperative really shouldn't work. Yet what might seem a gimmick conveys the dissociation of a transplanted Briton whose nationality dissolves into a haze of not only American but expressly expatriate clichés. "Say you like Boston fine but you don't know enough about the rest of America to judge: 'It's like asking someone in London what they think of Vienna.' Feel like an experienced traveller when you say this."

In "The Hull Case", a black husband pretends to believe in his white wife's oddball notion that they have been abducted by aliens; by implication, the mixed-race couple is forever labouring to credit the other's alien experience. In Mr Davies's most poignant tale, a recovering heroin addict takes in her elderly mother in order to persuade social workers that she is stable enough to regain custody of her baby. But however the aged mother tries to help, her encroaching senility becomes the state's reason not to return the child. The situations in "Equal Love" are never obvious, and Mr Davies writes in a sure, unselfconscious style, his gaze directed outwards.

George Saunders's "Pastoralia" is eye-wateringly hilarious—though acid social commentary burns beneath the jokes. In "Winky," a depressed, balding loser attends a self-help seminar, hoping to summon up the nerve to evict his schizophrenic sister. The seminar (in whose morality play actors labelled "Whiney", "Self-Absorbed", and "Blames Her Fat on Others" come between "You" and "Inner Peace") sounds no saner than the interior monologue of the gonzo sister. Alas, learning to keep other people from "crapping in your oatmeal" fails to harden the feckless brother's heart so that he can kick her out.

The title story chronicles the vicissitudes of a theme park employee living in a prehistoric diorama, where he roasts goats that arrive in the Big Slot and writes reports on his fellow cave-dweller, Jane. "Do I note any attitudinal difficulties? I do not. How do I rate my Partner overall? Very good. Are there any Situations which require Mediation? There are not. I fax it in." This American author has an ear for tacky, fraudulent and insidiously Stalinist corporate culture, and there's an ominous sense that he's exaggerating only a tad. The satire here is always funny and never cold.

Don't be put off by the fact that Keith Ridgway's "Standard Time" is packaged with the stark artlessness of a computer textbook. Inside, the Irishman's stories are artful indeed—literary yet not too showy, with a rolling, gathering cadence that is mesmerising. The circumstances he examines are wonderfully odd. Unusually for such a stylish, descriptive writer, Mr Ridgway is also a master of action.

Equal Love
By Peter Ho Davies

Houghton Mifflin; 192 pages; $12. Granta; £6.99

Buy it at
Amazon.com
Amazon.co.uk

Pastoralia
By George Saunders

Riverhead Books; 188 pages; $12. Bloomsbury; £9.99

Buy it at
Amazon.com
Amazon.co.uk

Standard Time
By Keith Ridgway

Faber and Faber; 248 pages; £9.99

Buy it at
Amazon.co.uk

The Collected Stories of Richard Yates
By Richard Yates

Henry Holt; 474 pages; $28

Buy it at
Amazon.com
Amazon.co.uk

In one story, a Dublin woman is harassed by a thuggish bookie, Mossie, whom her husband owes money. Later she comes upon a desolate little boy and tells him, whimsically, that her smelly, scrofulous dog is named “Mossie”. When the bookie returns and the boy calls quietly to the dog, “Here, Mossie!”, the results are calamitous. The story’s turn has the horrid freakishness of real life—“the play of small mistakes, the breath of lives, the teasing out of moments”. Likewise, in “Headwound” a cuckolded father hurls what he is utterly confident is a twig toward his small son, only for the boy to collapse with a hole in his head. Readers and police know the twig was a rock, and this tension between interior and exterior reality offers a frightening glimpse of real insanity.

One of the best publishing decisions this season was the issue of “The Collected Stories of Richard Yates”. Grossly under-appreciated, Mr Yates ranks among the finest post-war American chroniclers of middle-class angst. He easily equals heavy-hitters like John Updike or John Cheever, while never as self-involved as the former nor as provincial as the latter. Woefully, some of Mr Yates’s books have been allowed to slip out of print. His stories are often dolorous or bleak, but never nihilistic; Mr Yates, a four-packs-a-day smoker who died in 1994 after years of ill health, found significance in pain, especially disappointment. While by all accounts dyspeptic in person, he was pitying as well as unsparing on paper—a distinctly modern sensibility also displayed by Messrs Davies, Saunders and Ridgway.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Faith and politics in Iran

But what did he really mean?

May 31st 2001
From The Economist print edition

ISLAMIC thinkers search ceaselessly for the true rendering of dogma. But, as with every religion, no such rendering is to be found. In the 1960s an argument raged within the Islamic world about which social and political system was enjoined by the Koran: those of a socialist or communist persuasion cited verses from the Koran on a common, nomadic, ownership of land, water and fire; those in favour of capitalism and private property cited quotations from the *Hadith* attributed to the prophet Muhammad on the right to private property; some invoked Islamic traditions of feudalism, others even cited Koranic verses sanctioning slavery. Comparable debates on matters of contemporary concern, be it the position of women, the correct attitude to communications technology or the environment follow a similarly diverse path.

Reinventing Khomeini: The Struggle for Reform in Iran
By Daniel Brumberg

University of Chicago Press; 320 pages; $55 ($21 paperback) and £35 (Ã‚Â£13.50 paperback)

Buy it at
Amazon.com
Amazon.co.uk

The contribution of Ayatollah Khomeini to Islamic political thought was to offer one clear and robust answer to the question of politics and the form of an Islamic state: in contrast to many who argued that no Islamic state could be created in the absence of the direct successors of the Prophet, the imams, Khomeini maintained that it was possible to create an Islamic state in the contemporary world. This state could be guided by a learned clergyman, a *faqih*, who would act as the representative of the imam, and, by implication, of Allah. It was this idea, linked to a call for the just revolt of the oppressed against tyranny and against “world arrogance”—the United States and its allies, which provided an ideological base for the Iranian revolution.

Khomeini himself brooked little opposition in his lifetime. Yet, as Daniel Brumberg shows in this fascinating study, there are in regard to Khomeini’s thought and legacy many possible interpretations, just as there are of the Islamic tradition itself. Khomeini’s own thought combines different strands, elements of classical Islam, Shi’ite asceticism and mysticism, and, Mr Brumberg argues, elements of third-world radicalism absorbed through his followers. To these he could also have added a strong dose of Iranian nationalism.

The central conflict in Khomeini’s thinking is between the authoritarian model of power, in which all authority rests with the *faqih*, himself appointed by a coterie of senior clergy, or *ulema*, and the democratic or popular elements which gave the revolution and the Islamic Republic their initial legitimacy and which are also inscribed in the Iranian constitution. Since Khomeini’s death in 1989 disputes over his legacy have grown. Mr Brumberg examines how old anti-liberal elements inside the Iranian state, currently led by Ayatollah Khamanei, Khomeini’s successor as supreme leader, espouse the Khomeini legacy. He also illustrates, however, that many reformers, including the weak but dogged liberal President Khatami, now standing for re-election, do so as well.

The writings of revolutionary fathers, be they Khomeini, Mao or Lenin, allow for wide interpretation. But here, perhaps, we see the limits of Mr Brumberg’s approach, based as it is on studying the ayatollah’s speeches and Mr Khatami’s pleas for more liberal readings. For Khomeini’s legacy is more than textual: it is a state, complete with a system of laws and an authoritarian elite who control its guns and courts. These are not the sort to be moved by exhortations to pluralism from the founder. Khomeini can be reinterpreted and reinvented, many times over, but that will not, in itself, alter the dictatorship that he established and which Mr Khatami is trying, vainly so far, to contest.

Not that any of this would have surprised or bothered the ayatollah, who blithely declared: “I may have said something yesterday, changed it today, and will change it tomorrow. This does not mean that simply because I made a statement yesterday, I should adhere to it.” Khomeini could reinvent Khomeini; it is less clear how far others may do so.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

High society in New York

That other gilded age

May 31st 2001
From The Economist print edition

The Monied Metropolis: New York City and the Consolidation of the American Bourgeoisie 1850-1896
By Sven Beckert

Cambridge University Press; 492 pages; $34.95 and £25

Buy it at
Amazon.com
Amazon.co.uk

CLASS struggle in late 19th-century New York between old and new money was fought on many terrains, but none so fiercely as grand opera. Sven Beckert, a Harvard historian, recounts the following musical episode in his illuminating book on the upper social reaches of Manhattan in the gilded age.

At the New York Academy of Music, an exclusive venue for opera from 1854, 18 private boxes were monopolised by an old elite of Roosevelts, Stuyvesants and others. Most arrivistes reluctantly put up with this arrangement. But William Vanderbilt, a rail-and-shipping magnate's son, refused to settle for a seat in the stalls: he bid $30,000 for a box—and was rebuffed.

In riposte, he and other parvenus, including Goulds, Whitneys, Rockefellers and Morgans, contributed $10,000 each to incorporate a new opera boasting 122 private boxes, the Metropolitan Opera House Company. Unable to compete, the Academy of Music closed in 1885: "I cannot fight Wall Street," lamented its owner. Old money had no choice but to join the Met, and differences were quickly forgotten as the two foes found common cause in keeping out the next generation of newcomers.

AP

Worth the wait in Worth

The rich of New York had at one time looked with disdain on ostentatious displays of wealth, steeped as they were in America's "republican heritage and moral imperatives of frugality and thrift". But that changed dramatically, Mr Beckert explains, in the second half of the 19th century, when a few very rich families came to exercise extraordinary influence.

Many had made money elsewhere and moved to Manhattan to enjoy it, while continuing to draw wealth from outside the city and pull strings in the federal capital. Philip Armour, for instance, was a meat packer from Chicago, Andrew Carnegie, a Pittsburgh steel man and Maximillian Fleischmann, a yeast maker from Cincinnati. Whatever their origins, newcomers had to master—or manipulate—the snobberies of New York to be accepted.

A good address was vital: the best families moved ever farther uptown as immigrants degentrified lower Manhattan. Where and how you worshipped mattered, too, and there was, above all, a constant round of teas, receptions, dinners, parties, balls and cotillions. Wives would order 40 gowns from Worth in Paris each season. At a legendary Delmonico's dinner arranged by Leonard Jerome, Winston Churchill's grandfather, each woman found a gold bracelet hidden in her napkin. Mrs Stuyvesant Fish liked to throw lavish teas for her friends' dogs.

The men sought out the right clubs. A careful study by Mr Beckert of 128 New Yorkers at a society dance in 1891 shows them with 681 club memberships in all, the Union, Calumet, Racquet and Knickerbocker being among the favourites. In a hunt for ancestors, monied New Yorkers also joined the Genealogical Society.

As depicted by Mr Beckert, gilded-age New York suggests that, in one respect, Alexis de Tocqueville judged too soon. In the 1830s, the great French liberal had opined that, “In the United States the more opulent citizens take care not to stand aloof from the people.” For a later age, he could hardly have been more wrong.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

New fiction

What if

May 31st 2001
From The Economist print edition

REBECCA DAVITCH is having a crisis. She is 53 and feels an impostor in her own life. Somewhere along the line she has “turned into the wrong person”.

Rebecca met her husband, Joe Davitch, at the Open Arms, an elegant old Baltimore row house which the Davitches rent out for parties. Joe is easy-going and charming, with three children from a previous marriage. Rebecca is captivated. Her college sweetheart, the bookish Will Allenby, is soon forgotten, together with thoughts of an academic career. For Rebecca, one life has ended and another begun.

Back When We Were Grownups
By Anne Tyler

Knopf; 273 pages; $25.
Chatto & Windus; £15.99

Buy it at
Amazon.com
Amazon.co.uk

But what, she finds herself wondering three decades on, if she’d taken the other road? “Now she began to lead a whole other life—an imaginary, might-have-been life flowing almost constantly underneath the surface of her day-to-day existence.” Rebecca has been a widow for over 20 years; maybe the might-have-beens are still-could-bes. She gives Will a call.

“Back When We Were Grownups” is as perceptive, as full of gentle comedy and human warmth, as any of Ms Tyler’s previous novels. She manages her quirky, engagingly named characters (Patch, Biddy, NoNo, Jeep, Zeb) beautifully, spinning a web of family tensions with a wonderful lightness of touch—in this, Ms Tyler is matchless.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Modern drama

Summer of Sam

May 31st 2001
From The Economist print edition

All Samuel Beckett's plays are now on film. Would he have approved?

IN 1936 Samuel Beckett, arguably Ireland's greatest playwright, wrote to Sergei Eisenstein, arguably Russia's greatest film maker, to ask if he could train with the Moscow State Institute of Cinematography. This unlikely alliance came to nothing, but Beckett's interest in film persisted, notably in his collaboration with Buster Keaton on "Film" (Keaton's last silent movie). Radio and television plays such as "All that Fall" and "Eh Joe" show that Beckett was keen to explore different dramatic media. Nevertheless, he declined many offers to make films from his plays, including requests from such eminent directors as Ingmar Bergman.

The Beckett Estate has been courageous, then, in granting Michael Colgan (artistic director of the Gate Theatre in Dublin since 1983) and Alan Moloney the rights to film Beckett's stage plays. The goodwill and energy behind this project owe much to the Beckett Festival, presented by the Gate Theatre in 1991, which subsequently came to the Barbican in 1999. The producers have responded with admirable ambition, commissioning an exceptional array of talent to create cinematic realisations of all 19 of Beckett's theatre plays, in association with the Irish Film Board, RTE (an Irish broadcasting company) and Channel 4.

Although scheduled to be shown on television, these are really cinematic films best seen on a large screen. Taken all together, they are a strong reminder of Beckett's abiding love of Irish speech and idioms. This animates Michael Lindsay-Hogg's film of "Waiting for Godot". Barry McGovern, Johnny Murphy, Alan Stanford and Stephen Brennan appeared in the earlier theatrical production at the Barbican, and their ensemble-playing is confidently relaxed, overcoming the pitfalls waiting to drag "Godot" into ponderous stodge. "Godot" is the acid test. The directing and acting vindicate the transfer from stage to film, but the combination of cinematic setting and varying camera angles is distractingly awkward.

Many of these films seem unable to focus and analyse the still image or tableau—a central resource of Beckett's theatre. An otherwise engaging version of "Happy Days" is filmed in the volcanic landscape of Tenerife. Rosaleen Linehan battles womanfully with the elements, but her triumph over adversity threatens to look like a surreal parody of a television holiday programme. Similarly, although there is an authority to John Hurt's performance in "Krapp's Last Tape", the film set adds clutter rather than illumination. Beckett's plays depend on a subtle understanding of the stage as a place of artifice, performance and imprisonment. At its simplest, in "Act Without Words I", the box-set of the theatre becomes a farcical torture-chamber. Transferred to film by Karel Reisz, with music by Michael Nyman, the cinematic framing of the image loses this sense of theatricality. With this loss goes the sinister evocation of off-stage forces. By contrast, Kieron Walsh's "Rough for Theatre I" is clever and resourceful, featuring memorable performances by David Kelly and Milo O'Shea and an acute freeze-frame ending.

Beckett's less polished sketches seem to liberate cinematic ingenuity, where his more developed conceptions of theatricality can prove resistant to adaptation. Anthony Minghella's "Play" attempts to compensate for the loss of the play's interrogative spotlight with a drama of the camera's focus and brief jump-cuts. The talents of Alan Rickman, Juliet Stevenson and Kristen Scott-Thomas nevertheless conspire with Mr Minghella's bravura film-making technique to crush the play's humours.

Beckett's distrust of adaptations was principled. His own adaptations, notably of "Not I", suggest that decisive formal changes are necessary to compensate for the loss of theatricality. Without the characteristically stifled and knowingly awkward laughter that usually accompanies Beckett's plays in the theatre, his texts can appear denuded, clumsily formalist and tediously inhuman. Beckett's favourite play, "Endgame", is perhaps most wounded by its loss of a theatre and audience, despite Michael Gambon's best efforts as Hamm.

One suspects that Beckett would have viewed many of these adaptations with mounting horror. Too

many cinematic gimmicks are distracting and fussy. The star-studded collaborations are perhaps the most disappointing. Damien Hirst's "Breath" is characteristically bland. David Mamet's version of "Catastrophe" boasts Harold Pinter as the Director and the late John Gielgud as the Protagonist, but Beckett's severe auto-critique of theatre becomes tepid and self-congratulatory.

The success of the Barbican's Beckett festival indicated the existence of an audience for intelligent modern drama that has been increasingly neglected by institutions such as the BBC (which commissioned work by Beckett in his lifetime). Beyond the changing trends in public service broadcasting, there are further ironies in the embrace of Beckett by Irish culture, given the history of their mutual suspicions. RTE is to be congratulated for a courageous and excitingly diverse attempt to bring avant-garde theatre to the screen. The project as a whole will be necessary viewing for anyone interested in the fate of modern drama. Is it too much to hope that comparable invitations to explore the medium of film might be extended to living dramatists?

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Correction

May 31st 2001
From The Economist print edition

Because of an editorial oversight, we omitted to disclose last week that Morton Kondracke, author of "Saving Milly", is executive editor of *Roll Call*, part of The Economist Group. In line with our normal policy, we should therefore have given the name of the reviewer, Charlotte Johnson-Wahl.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Jazz biography

Black fantasy

May 31st 2001
From The Economist print edition

WHENEVER Duke Ellington's music was subjected to abstract analysis he liked to say, "That kind of talk stinks up the place." He might occasionally lob the same rebuke at his latest biographer. A.H. Lawrence, a trained psychiatrist, expresses Ellington's devotion to his doting mother in Freudian terms. When the successful young bandleader moves her into his home in Harlem, it signifies "the blatant realisation of Oedipal wishes".

Duke Ellington and His World: A Biography
By A.H. Lawrence

Routledge; 510 pages; $35 and £19.99

Buy it at
Amazon.com
Amazon.co.uk

Well, perhaps. But mostly Mr Lawrence approaches his fascinating subject not from the consulting room but as an acquaintance and fellow-musician. As a young jazz trombonist, Mr Lawrence met Ellington several times. Over 20 years he established ties with many of the great man's sidemen, friends and family. The heart of his volume is their first-hand remembrances of the Duke, affectionate but frank, amplified by the author's scrupulous research and well-informed musical judgments. The result is an evocative and engrossing portrait of Ellington and Ellingtonia—one of the best available.

The composer emerges as a shameless charmer. Women, audiences and even heads of state adored him. So, importantly, did the musicians who provided material for his unique body of work. Ellington once described himself as "a great listener", incorporating anything that appealed to him into his music and shaping it with an uncanny, wholly original sense of colour and harmony. He was a great observer too, taking the myriad impressions of a life constantly in motion as his inspiration, from the Harlem of his youth, where he reigned as musical king of the celebrated Cotton Club, to the international tours of his later years. Above all, he was committed to what he called "the rich background of the Negro", which he conveyed in a host of pieces such as the early "Black and Tan Fantasy" and culminating in a concert-length masterwork, "Black, Brown and Beige".

In his extended compositions, Ellington sought to assert jazz's right to the same respect as classical music. Some populist critics decried this ambition, and John Hammond, a well-to-do liberal impresario, denounced Ellington's concert works as vapid, accusing him of ignoring the troubles of his people. As Mr Lawrence puts it, Ellington "must have wondered what gave the grandson of the wealthy, white Vanderbilt and Sloane families the right to tell the grandson of two slaves that his music wasn't 'black enough'." It is at such moments that the reader really feels Mr Lawrence's thorough grasp of Ellington's world.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

American press

Bring me a real paper

May 31st 2001
From The Economist print edition

IN 1958, *The Economist* accurately described the *Los Angeles Times* as "a shoddy sheet of extreme right-wing viewpoint". It had a deserved reputation for being one of America's worst, if most profitable, newspapers. S.J. Perelman of the *New Yorker* liked to tell how once when his train stopped in Albuquerque, New Mexico, he had asked a porter to bring him a newspaper. "Unfortunately," Perelman recalled, "the poor man, hard of hearing, brought me the *Los Angeles Times*." Barely 20 years later, the paper was one of the country's best, regularly ranked with the *New York Times*, the *Washington Post* and the *Wall Street Journal*. Its transformation was largely the work of one man, Otis Chandler, the great grandson of the paper's founder. "Privileged Son" by Dennis McDougal, a former reporter for the *Los Angeles Times*, is the story of how Chandler did it, and how he did so in the face of opposition from others in his deeply conservative family who regarded his moderate views as virtually those of a communist.

Privileged Son: Otis Chandler and the Rise and Fall of the L.A. Times Dynasty
By Dennis McDougal

Perseus Publishing; 526 pages; $35 and £24.99

Buy it at
Amazon.com
Amazon.co.uk

It is an improbable story in some ways, for Mr Chandler appeared an unlikely person to lead the paper to excellence. His interest in sports, hunting and antique cars seemed far stronger than any passion for the news business. Yet he strove relentlessly to give the paper "mass and class". His remarkable success and his equally surprising departure is a riveting story of power and ambition, corporate skullduggery and long internecine warfare, culminating in the disputed sale of the family business to outsiders.

Mr Chandler was made publisher at the age of 32 in 1960. Still smarting from the hazing he received at the hands of snotty easterners when he attended Andover, Mr Chandler bridled at the second-class treatment he got from what he called "the group": the *New York Times*, *Christian Science Monitor*, *Boston Globe* and *Atlanta Journal-Constitution*. He vowed to get respect. "I wanted", he would later say, "to make them eat their bloody words." How he went about doing so is an inspiring story of a man possessed by a ferocious competitive spirit and a curiosity about how the world worked.

More surprising is how Mr Chandler, at 52, then withdrew from the paper he had worked so assiduously to professionalise, absenting himself from the paper and the city he and his family had done so much to develop. Instead, he turned the family plantation over to high-priced overseers whose interest was almost solely the bottom-line. For this betrayal, Mr Chandler suffered no apparent penalties from the city's social elite to which he belonged.

It is here that "Privileged Son" marks a real difference between the newspaper aristocrats of, say, New York or Washington, and their west coast counterparts. It is unthinkable that a Sulzberger or Graham could abandon the family newspaper without enduring the disdain of their class. It says much about Los Angeles and the lack of cohesion of its elite that Mr Chandler could virtually disappear into the African bush on a quest to reduce the world's population of wild animals, and not be missed in the tonier precincts of Hancock Park or San Marino—the gilded ghettos of sunny southern California.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

German press

Red and white all over

May 31st 2001
From The Economist print edition

IN THE right circumstances, owning a newspaper can be a licence to print money. In post-war Germany the cliché was apt. The allied authorities controlled licences to run a paper. Newsprint was short and owners had to be clean of Nazism. So few licences were granted, and those who got them had every chance of becoming very rich. Gerd Bucerius, a Hamburg lawyer and politician, was among the lucky ones. In 1946 he and three associates won permission to start a weekly newspaper, *Die Zeit*.

Liberal und UnabhÃ¤ngig: Gerd Bucerius und seine Zeit
By Ralf Dahrendorf

C.H. Beck; 304 pages; DM48

Buy it at
Amazon.de

What began in a ravaged city as a small-circulation, financially weak paper with largely conservative views soon grew to become West Germany's liberal high table, an arbiter of intellectual opinion and a national institution which includes a former federal chancellor, Helmut Schmidt, as one of its publishers. It is not far-fetched to say that *Die Zeit* played a part, particularly in the 1960s, in the German consolidation of democracy.

Along the way, Mr Bucerius, who died in 1995, became one of Europe's richest tycoons, the third member of a Hamburg trio that included his sometime rivals, sometime friends: Axel Springer, owner of the mass-circulation *Bild-Zeitung*, and Rudolf Augstein, head of *Der Spiegel* news magazine. For a time, Mr Bucerius stayed active in politics as a Christian Democrat member of parliament and junior minister under Konrad Adenauer. But he fell out with the chancellor in 1960, and from then on devoted his large energies, meddlesome attention to detail and astute tactical capacities to *Die Zeit*, where his opinion pieces were often at odds with those of his more liberal editors-in-chief. Having edged out his old *DieZeit* partners in the 1950s, he proceeded, by complex and underhand manoeuvres, to wrest control of *Stern* magazine from another Hamburg licensee, Henri Nannen.

With its popular, often sensationalist approach *Stern* was a world away from the highbrow and impeccably anti-populist *Die Zeit*. Commercially, however, *Stern* was a goldmine and formed the core of Bucerius's fortune. In the mid-1960s he created Gruner + Jahr, selling his share in it later to Bertelsmann, Germany's world media giant, for 11% of its stock.

As a liberal German intellectual who went on to achieve academic success in Britain, Ralf Dahrendorf is exactly the right author to write Bucerius's life. In "Liberal und Unabhängig" (Liberal and Independent) he is respectful about a man he knew and dealt with, but without being overawed by him. His book brings out the typically German way in which a rich publisher satisfied both popular and high-brow taste, and it notes nostalgically how the buccaneering days are over. The old press barons, whose business and personal lives felt so large, are dead. The companies they founded live on, but much of their passion is gone.

So this handsome book is both the biography of a remarkable German grandee and an epitaph for an era. The story of *Die Zeit*, which was sold soon after Mr Bucerius's death to Holtzbrink, another big German media concern, in many ways mirrors the cultural development of post-war western Germany: spare and intellectually vital in the early decades, verbose and slightly dull nowadays. But, as with Germany itself, change is afoot at *Die Zeit*. For the second time in five years the whole paper is being editorially overhauled.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

American and German bestsellers

What the world is reading

May 31st 2001
From The Economist print edition

Fantasy, prison and history are some of readers' current preoccupations

THERE are two things to notice in the current fiction tables. In the German list, J.R.R. Tolkien's fantasy classic, "The Lord of the Rings", has conjured its way in at number ten, perhaps in the wake of Tolkienish Harry Potter, which dominates the top four slots. Third on the American list (from which Potter is excluded), Anne Tyler's novel "Back When We Were Grownups" (reviewed in this week's issue) shows she can write popular literary fiction of the highest order.

In a sea of self-help, a striking item on the American non-fiction list is "Stolen Lives", a translation from French about political oppression in Morocco. Laura Hillenbrand's "Seabiscuit" is still galloping off the shelves and Tom Brokaw has succeeded again with his third compilation about Americans in the second world war.

German readers, too, are intrigued by the past. Sebastian Haffner, a German, and Norman Finkelstein, an American, deal respectively with the seeds and consequences of Nazism. Günther de Bruyn taps Prussian patriotism in a life of beautiful Queen Luise. Germany's David Lodge, Dietrich Schwanitz, made a mark with a satire, "Der Campus". Now he has put what you ought to remember from class but don't into one book, which is getting good marks in sixth place.

Bestsellers

	AMERICAN FICTION	AMERICAN NON-FICTION
1	**Chosen Prey** *by John Sandford* Serial killer thriller	**The Prayer of Jabez** *by Bruce Wilkinson* How to live a blessed life
2	**On the Street Where You Live** *by Mary Higgins Clark* Murder by the seaside	**Who Moved My Cheese?** *by Spencer Johnson* Million-selling self-help book
3	**Back When We Were Grownups*** *by Anne Tyler* Family drama	**Body for Life** *by Bill Phillips and Michael D'Orso* Three months to total health
4	**A Common Life: The Wedding Story** *by Jan Karon* Father Tim and Cynthia's wedding	**Stolen Lives** *by Malika Oufkir and Michele Fitoussi* 20 years in a Moroccan prison
5	**Dreamcatcher** *by Stephen King* Supernatural thriller	**Life Makeovers** *by Cheryl Richardson* Self-improvement tips
6	**The Last Time They Met** *by Anita Shreve* Passionate thriller	**Napalm and Silly Putty** *by George Carlin* Ruminations of a stand-up comedian
7	**A Painted House** *by John Grisham* Non-legal non-thriller	**Foley Is Good: And the Real World Is Faker than Wrestling** *by Mick Foley* Behind the scenes in the WWF
8	**Death in Holy Orders** *by P.D. James* Bad guys in cassocks	**An Album of Memories** *by Tom Brokaw* Letters and photos documenting the American experience in the second world war
9	**The Summerhouse** *by Jude Deveraux* Old friends reunited in a reflective mood	**Seabiscuit** *by Laura Hillenbrand* Story of a great racehorse
10	**The Bonesetter's Daughter** *by Amy Tan* Chinese-American family drama	**Secrets of the Vine** *by Bruce Wilkinson* Bearing fruit for Jesus

	GERMAN FICTION	GERMAN NON-FICTION
1	**Harry Potter und der Feuerkelch** *by J.K. Rowling* Harry in wizard tournament	**Geschichte eines Deutschen** *by Sebastian Haffner* Memoir of the interwar years
2	**Harry Potter und der Stein der Weisen** *by J.K. Rowling* Harry starts wizard school	**Duden: Die deutsche Rechtschreibung** *published by Bibliographisches Institut Mannheim* Spelling and grammar reference book
3	**Harry Potter und der Gefangene von Askaban** *by J.K. Rowling* Convict on the run after trainee wizard	**Das Erfolgsprogramm** *by Ulrich Strunz* Unconventional fitness bible
4	**Harry Potter und die Kammer des Schreckens** *by J.K. Rowling* More Harry and more wizardry	**Älter werde ich später** *by Iris Berben* Secrets of ageing beautifully
5	**Der Mann, der lächelte** *by Henning Mankell* Swedish thriller	**Doppelleben: Eine Autobiographie** *by Carola Stern* Autobiography of a journalist and sometime spy
6	**Der ewige Gärtner** *by John le Carre* Diplomat takes on pharmaceutical giant	**Bildung: Alles, was man wissen muß** *by Dietrich Schwanitz* Curriculum for life
7	**Die Brüderschaft** *by John Grisham* Blackmail at the highest level	**Ein Blick zurück, ein Schritt nach vorn** *by Gregor Gysi* Memoirs of former chairman of Germany's PDS
8	**Handbuch des Kriegers des Lichts** *by Paulo Coelho* Searching for love	**Generation Golf: Eine Inspektion** *by Florian Illies* Young journalist looks back on recent fads and fashions
9	**Duddits** *by Stephen King* Supernatural thriller	**Die Holocaust-Industrie** *by Norman Finkelstein* Controversial assessment of the Holocaust and its legacy
10	**Der Herr der Ringe** *by J.R.R. Tolkien* Classic fantasy epic	**Preußens Luise** *by Günther de Bruyn* Life of Queen Luise

Sources: *Publishers Weekly; Focus* * Reviewed in this week's issue Descriptions by *The Economist*

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Corporate profiles

From forests to phones

May 31st 2001
From The Economist print edition

HOW did a forestry company founded in the 1860s in Finland transform itself into the world's leading mobile-phone maker? Nokia's unusual tale is told by Dan Steinbock, a former telecoms consultant. He believes that other firms can learn from Nokia, and has stuffed his book with odd graphs, baffling org-charts, sprawling block diagrams and obfuscatory clerk-speak that drizzles without pause from modern management: "Through its process configuration and drivers, Nokia has built its global focus advantage."

The Nokia Revolution
By Dan Steinbock

Amacom; 375 pages; $27.95 and £20.99

Buy it at
Amazon.com
Amazon.co.uk
Amazon.com
Amazon.co.uk

Nokia started off in forestry, and later moved into making paper, rubber, and electrical cables. By the 1980s it was a shapeless conglomerate that made everything from tyres to TVs. It also made mobile phones, which took off after the establishment of a multinational cellular network by a consortium of Scandinavian state operators. This network, which had low subscription rates and country-to-country roaming, gave the Scandinavians a clear edge when it came to setting up Europe-wide networks based on the digital GSM standard in the early 1990s. (Other European countries, along with Japan and America, fell behind, having adopted proprietary systems.) Initially, GSM was known as the "Great Software Monster", because it was so complex, and making it work proved harder than expected. But Nokia's GSM team, led by Jorma Ollila, got it to work. Mr Ollila was made chief executive, and once Nokia concentrated on mobiles, it shot ahead of rivals.

Since then, Nokia has stayed in front by emphasising design—mobile phones are fashion statements—and of easy-to-use software. The company has also positioned itself to take advantage of the coming convergence between mobile phones and the Internet. There is undoubtedly an exciting book to be written about Nokia. But Mr Steinbock's account, while comprehensive, is not it.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Malcolm McLean

May 31st 2001
From The Economist print edition

Malcolm Purcell McLean, pioneer of container ships, died on May 25th, aged 87

AP

THE first container ship was an elderly oil tanker, the *Ideal X*, whose deck had been strengthened to accommodate 58 well-filled boxes each some 30ft (9 metres) long. Malcolm McLean, normally an unemotional man, as befitted his Scottish ancestry, watched with a twinge of anxiety as the ship left Port Newark in New Jersey. Would the boxes survive the long journey down the east coast, into the Gulf of Mexico and on to Houston? Or might some of the boxes, or all of them, be swept unrecoverably into the sea, as some doubters had predicted? Would the valuable cargoes themselves arrive undamaged after the *Ideal X*, described by a reporter as an "old bucket of bolts", had been buffeted by Atlantic gales?

They seemed reasonable worries at the time, but even had the *Ideal X* sunk, the probability is that containerisation would have only been delayed for a year or two. Trade was ready for it. Mr McLean had the determination to push aside the initial obstacles. In fact the first voyage went without a hitch. Mr McLean's pioneer clients were delighted with the savings made by moving their freight from roads to sea. April 26th 1956, the day the *Ideal X* sailed, is seen as a marker in maritime history. On the 40th anniversary in 1996, by which time around 90% of world trade was moving in containers on specially designed ships, New York threw a party for Mr McLean, variously described as shipping's "man of the century" and the inventor of "the greatest advance in packaging since the paper bag". Bill Clinton simply said, accurately, that containerisation had helped to "fuel the world's economy".

Mr McLean disliked fuss. He was polite to reporters but avoided publicity. He hated the telephone, preferring to conduct a business discussion face to face. He liked, he said "to look someone in the eye". You could have a frank talk. That was how they did business in Maxton, North Carolina, where he was brought up.

Birth of an idea

He was a farmer's son, one of seven children. His first business transaction was selling eggs for his mother, taking a small commission. But in the 1930s, the time of the Great Depression, farming was one of the worst-hit industries. Mr McLean got a job at a petrol station and saved enough money to buy a secondhand lorry, calling himself, grandly, the McLean Trucking Company. He did well enough to buy five more lorries, hired drivers for them, but continued to drive himself.

He said the idea that gave birth to containerisation came to him one day in 1937. He had delivered a load of cotton bales to the port of Hoboken, for shipment abroad. In later life Mr McLean recalled the moment to *American Shipper*, a magazine:

> I had to wait most of the day to deliver the bales, sitting there in my truck, watching stevedores load other cargo. It struck me that I was looking at a lot of wasted time and money. I watched them take each crate off a truck and slip it into a sling, which would then lift the crate into the hold of the ship. Once there, every sling had to be unloaded, and the cargo stowed properly. The thought occurred to me, as I waited around that day, that it would be easier to lift my trailer up and, without any of its contents being touched, put it on the ship.

Mr McLean did not rush to pursue the idea. First, he set out to become rich. By 1940 he had 30 lorries. In 1955, when he had decided that containerisation was the future, he sold his trucking business for $6m,

equivalent to $40m today.

It seems unlikely that Mr McLean was the first to notice that the “break-bulk” shipping of goods, as it was called, could be improved on. There used to be a rather romantic train called the Golden Arrow which each evening travelled from London to Paris, the coaches crossing the English Channel by ship without the passengers having to get out. No doubt there are other examples. Perhaps the Romans thought of it. All the idea needed was an enthusiast.

But for centuries the trade of the world had depended on there being a vast labour force at every port to handle goods in manageable quantities. So why change? For Mr McLean the lure was lower costs. Moving a shipload of containers from the north to the south of the United States, as happened in the voyage of the *Ideal X*, was itself cheaper than trucking the containers individually. As the cost of dock labour was reduced, savings of as much as 25% could be passed on to the shippers. As containerisation spread around the world, ships were turned round more quickly with more savings.

In 1969, when Mr McLean sold for $160m his share in Sea-Land, the business he had created, it was the world’s biggest container carrier. He guessed, correctly, that container ships would grow and grow. The latest are over 1,000ft in length, as fast as speedboats, accommodating hundreds of containers, and with small crews. Mr McLean said approvingly, “People are never going to pay a lot of money just to move things.” He never really retired. He devised a way of moving a patient from a stretcher to a hospital bed with the minimum of discomfort. He started a pig farm, which had the reputation of being one of the cleanest in the United States. In Maxton, he said, the farmers always treated their pigs decently.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Overview

May 31st 2001
From The Economist print edition

America's Bureau of Economic Analysis lowered its estimate of first-quarter GDP growth from an annual rate of 2.0% to 1.3%. The sharpest inventory reduction since 1983 made the downward revision bigger than expected. On the plus side, the Conference Board reported a rebound in its index of consumer confidence. Year-on-year growth in retail sales also climbed, to 2.5% in April. A profit warning from Sun Microsystems tipped the balance on the country's stockmarkets, however; the Nasdaq shed 7.1%.

Canada has caught a touch of slowdown sickness. In the year to March its retail sales increased at the slowest rate since May 1999—only 3.0%.

Unemployment in **Japan** edged back up to 4.8% in April, leaving the rate only 0.1% shy of its record level. Meanwhile, industrial production continued to decline, down by 3.9% in the year to April, to its lowest level since July 1999. So far this year, production has fallen at an annual rate of almost 20%. Consumer-price deflation held steady at 0.4% in the year to April. Downgrades to high-tech firms such as Toshiba, and worries about banks' bad loans, pulled the Nikkei down by 4.1%, to a six-week low.

Technology firms' profit warnings in **Britain** contributed to more stockmarket gloom; the FTSE finished the week 1.7% lower. Year-on-year GDP growth in the first quarter was revised slightly upwards, to 2.6%, but that is still below its long-term average.

The **euro area**'s 12-month current-account deficit widened from $28.9 billion in February to $32.6 billion in March, with declining imports in America partly to blame.

Commodities

Iraq says it will cut off its **oil** exports under the United Nations oil-for-food programme, due for renewal on June 3rd, if the Security Council adopts the British-American proposal for "smart sanctions". These measures aim to ease restrictions on Iraq's civilian imports while cracking down on military imports and oil smuggling. Russia and China want the current system extended, to allow time for more discussion. Iraq exports about 2.2m barrels of oil a day. Saudi Arabia says that OPEC could help fill the gap in supply, but the cartel is unlikely to raise its output ceiling at its meeting next week.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Output, demand and jobs

May 31st 2001
From The Economist print edition

Output, demand and jobs

% change at annual rate

	GDP		The Economist poll GDP forecasts		Industrial production	Retail sales (volume)	Unemployment % rate	
	1 qtr	1 year	2001	2002	1 year	1 year	latest	year ago
Australia	− 2.2	+ 2.1 Q4	+ 2.1	+ 4.0	+ 3.1 Q4*	+ 3.0 Q1	6.8 Apr	6.6
Austria	+ 1.7	+ 2.6 Q4	+ 2.2	+ 2.5	− 5.0 Mar*	+ 4.9 Jan	3.7 Mar	3.9
Belgium	+ 1.8	+ 2.4 Q1	+ 2.6	+ 2.6	+ 5.7 Mar*	− 2.8 Feb	10.2 Apr*	10.5
Britain	+ 1.7	+ 2.6 Q1	+ 2.3	+ 2.8	− 0.1 Mar	+ 5.9 Apr	5.1 Mar‡	5.8
Canada	+ 2.6	+ 4.0 Q4	+ 2.1	+ 3.2	+ 1.5 Feb	+ 3.0 Mar	7.0 Apr	6.8
Denmark	+ 4.9	+ 1.1 Q4	+ 1.9	+ 2.2	+ 5.2 Mar	− 0.6 Feb	5.4 Mar	5.3
France	+ 2.0	+ 2.7 Q1	+ 2.6	+ 2.7	+ 1.9 Mar	+ 1.9 Mar	8.7 Apr	9.9
Germany	+ 1.5	+ 1.6 Q1	+ 1.9	+ 2.5	+ 1.4 Mar	− 0.6 Mar	9.3 Apr	9.6
Italy	+ 2.8	+ 2.3 Q1	+ 2.2	+ 2.4	− 0.3 Mar	− 0.2 Mar	9.9 Jan	11.2
Japan	+ 3.0	+ 2.8 Q4	+ 0.6	+ 1.3	− 3.9 Apr	+ 2.1 Mar	4.8 Apr	4.8
Netherlands	+ 0.2	+ 2.0 Q1	+ 2.8	+ 2.9	+ 2.0 Mar	− 3.1 Feb	2.0 Apr§	2.7
Spain	+ 2.9	+ 3.7 Q4	+ 2.8	+ 3.1	− 3.7 Mar	na	13.5 Mar	14.8
Sweden	+ 2.4	+ 2.6 Q4	+ 2.6	+ 2.9	+ 6.2 Feb	+ 2.3 Mar	3.7 Apr*	4.7
Switzerland	+ 1.8	+ 2.5 Q4	+ 1.9	+ 2.2	+ 5.0 Q4*	− 0.6 Feb	1.7 Apr*	2.1
United States	+ 1.3	+ 2.5 Q1	+ 1.5	+ 3.0	− 1.0 Apr	+ 2.5 Apr	4.5 Apr	4.0
Euro area	+ 2.8	+ 3.0 Q4	+ 2.3	+ 2.6	+ 3.0 Mar	+ 1.2 Feb	8.4 Mar	9.2
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*							
Finland	+ 3.0	+ 5.5 Q4	na	na	+ 0.7 Apr	+ 5.5 Feb	10.3 Apr*	11.0
Greece	na	+ 2.5 2000	na	na	+ 1.9 Dec	+11.8 Jan	na	na
Iceland	na	+ 4.4 1999	na	na	+ 4.2 1999	na	1.3 Jan	1.5
Ireland	na	+11.0 Q3	na	na	+23.0 Mar*	+ 1.6 Mar	3.6 Apr	4.3
Luxembourg	na	+ 8.5 2000	na	na	+ 0.2 Feb*	+ 9.4 Nov	2.6 Mar	2.7
New Zealand	+ 2.2	+ 1.6 Q4	na	na	+ 0.9 Q4*	+ 1.7 Q1	5.4 Q1	6.4
Norway	+ 0.3	+ 1.0 Q4	na	na	− 2.8 Mar	+ 0.8 Mar	3.7 Q1	3.9
Portugal	+ 2.2	+ 3.4 Q4	na	na	+ 6.0 Mar*	− 0.6 Feb	3.8 Q4	4.1

*Not seasonally adjusted. ‡Jan-Mar; claimant count rate 3.2% in April. §Feb-Apr.

Text refers only to the first 16 countries listed

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Prices and wages

May 31st 2001
From The Economist print edition

Prices and wages

% change at annual rate

	Consumer prices*			The Economist poll consumer prices forecast		Producer prices*			Wages/earnings		
	1 year		year ago	2001	2002	1 year		year ago	1 year		year ago
Australia	+ 6.0	Q1	+ 2.8	+ 3.6	+ 2.3	+ 5.2	Q1	+ 5.6	+ 5.6	Q1	+ 2.9
Austria	+ 2.9	Apr	+ 1.9	+ 1.8	+ 1.4	+ 2.9	Apr	+ 2.6	+ 2.5	Mar	+ 2.1
Belgium	+ 3.1	May	+ 2.2	+ 1.9	+ 1.7	+ 3.8	Mar	+ 8.6	+ 1.9	Q1	+ 3.3
Britain	+ 1.8	Apr	+ 3.0	+ 1.9	+ 2.3	+ 0.5	Apr	+ 2.3	+ 5.1	Mar	+ 5.7
Canada	+ 3.6	Apr	+ 2.1	+ 2.3	+ 2.1	+ 2.7	Apr	+ 5.7	− 0.9	Feb	+ 2.8
Denmark	+ 2.7	Apr	+ 3.1	+ 2.2	+ 2.2	+ 3.6	Apr	+ 5.7	+ 3.8	Q4	+ 4.1
France	+ 1.8	Apr	+ 1.3	+ 1.3	+ 1.4	+ 2.9	Apr	+ 3.5	+ 5.0	Q4	+ 3.4
Germany	+ 3.5	May	+ 1.4	+ 2.0	+ 1.4	+ 4.1	Apr	+ 4.4	+ 1.7	Mar*	+ 2.1
Italy	+ 3.0	May	+ 2.5	+ 2.4	+ 1.9	+ 4.3	Apr	+ 5.4	+ 2.6	Apr*	+ 2.1
Japan	− 0.4	Apr	− 0.8	− 0.4	− 0.3	+ 1.3	Apr	− 0.4	+ 0.5	Mar	+ 2.1
Netherlands	+ 4.9	Apr	+ 2.1	+ 3.9	+ 2.2	+ 5.6	Apr	+ 7.3	+ 2.9	Mar	+ 3.4
Spain	+ 4.0	Apr	+ 3.0	+ 3.1	+ 2.6	+ 3.2	Mar	+ 5.7	+ 2.2	Q4	+ 2.4
Sweden	+ 2.8	Apr	+ 1.1	+ 1.7	+ 1.7	+ 3.3	Apr	+ 3.3	+ 1.5	Feb*	+ 3.4
Switzerland	+ 1.8	May	+ 1.6	+ 1.2	+ 1.2	+ 0.9	Apr	+ 2.8	+ 0.2	1999	+ 0.7
United States	+ 3.3	Apr	+ 3.1	+ 2.9	+ 2.3	+ 3.7	Apr	+ 3.6	+ 4.3	Apr	+ 3.8
Euro area	+ 2.9	Apr	+ 1.9	+ 2.1	+ 1.6	+ 4.1	Mar	+ 4.9	+ 2.4	Q4	+ 2.3
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 3.0	Apr	+ 2.7	na	na	+ 3.0	Apr	+ 7.1	+ 4.3	Q4*	+ 3.5
Greece	+ 3.5	Apr	+ 2.6	na	na	+ 4.3	Mar	+ 7.9	na		na
Iceland	+ 5.5	May	+ 5.9	na	na	+ 5.7	May	+ 3.6	+ 9.2	Apr	+ 5.3
Ireland	+ 5.6	Apr	+ 4.9	na	na	+ 2.9	Apr	+ 5.4	+ 7.4	Q3*	+ 6.6
Luxembourg	+ 2.8	Apr	+ 2.7	na	na	+ 3.6	Mar	+ 3.2	+ 8.4	Oct*	+ 1.7
New Zealand	+ 3.1	Q1	+ 1.5	na	na	+ 7.8	Q1	+ 4.9	+ 1.8	Q1	+ 1.4
Norway	+ 3.8	Apr	+ 2.6	na	na	+ 9.8	Apr	+ 6.2	+ 4.3	Q4*	+ 4.0
Portugal	+ 4.5	Apr	+ 2.1	na	na	+ 4.7	Mar	+18.6	+ 2.2	Feb*	+ 2.8

*Not seasonally adjusted.

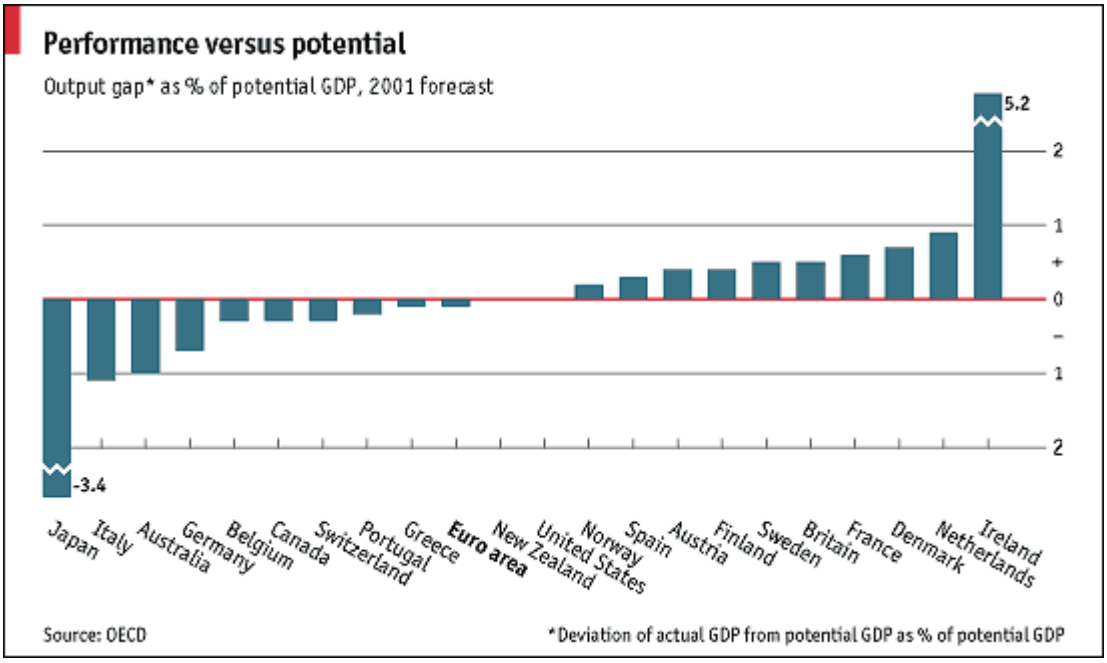
Text refers only to the first 16 countries listed

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Performance versus potential

May 31st 2001
From The Economist print edition

The “output gap” is the difference between an economy’s actual and potential GDP, ie, the level of output consistent with full employment and stable inflation. Economies with positive gaps are outpacing their trend growth and so risking higher inflation; negative gaps mean that faster growth is safe. Measuring gaps is as much art as science. The OECD estimates that Japan and Ireland have, respectively, the biggest negative and positive gaps.

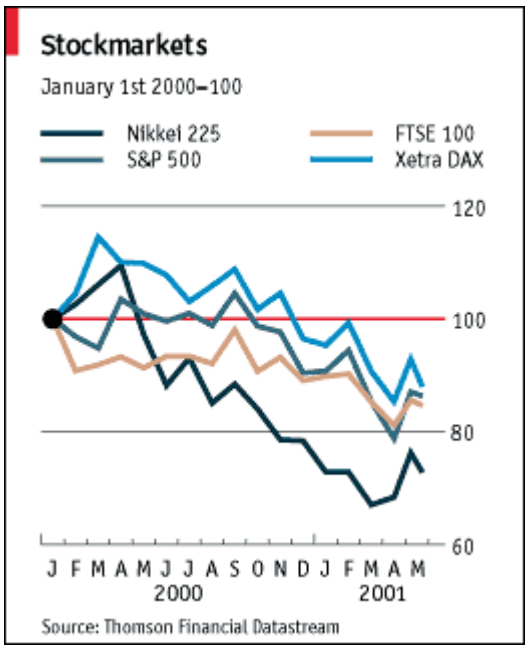


Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Stockmarkets

May 31st 2001
From The Economist print edition

Equities have fallen sharply around the world since their peaks of early last year. Despite the focus on Wall Street's woes, it is Japan that has suffered the worst setback among the biggest stockmarkets.



Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Commodity price index

May 31st 2001
From The Economist print edition

1995=100

	May 22nd	May 29th*	% change on one month	% change on one year
Dollar index				
All items	71.7	70.4	– 0.6	– 4.9
Food	68.0	67.3	– 1.4	– 7.8
Industrials				
All	76.7	74.7	+ 0.4	– 1.0
Nfa†	76.6	73.8	+ 2.2	+ 1.1
Metals	76.9	75.4	– 1.0	– 2.7
Sterling index				
All items	79.2	78.3	+ 0.4	+ 0.4
Euro index				
All items	108.9	108.4	+ 3.7	+ 3.8
Yen index				
All items	93.6	90.0	– 2.2	+ 7.5
Gold				
$ per oz	282.85	274.55	+ 4.0	+ 0.5
West Texas Intermediate				
$ per barrel	29.42	28.83	+ 1.7	– 4.9

* Provisional. † Non-food agriculturals.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Stockmarkets

May 31st 2001
From The Economist print edition

Stockmarkets

Market indices

	May 30th	2001 high	2001 low	% change on one week	% change on record high	% change on Dec 31st 2000 in local currency	% change on Dec 31st 2000 in $ terms
Australia (All Ordinaries)	3,339.9	3,370.7	3,094.3	– 0.7	– 0.9	+ 5.9	– 2.1
Austria (ATX)	1,184.1	1,222.1	1,052.2	– 1.1	–31.8	+10.3	+ 0.7
Belgium (Bel 20)	2,813.2	3,030.4	2,591.6	+ 0.4	–23.6	– 7.0	–15.1
Britain (FTSE 100)	5,796.9	6,334.5	5,314.8	– 1.7	–16.4	– 6.8	–11.3
Canada (Toronto Composite)	8,101.4	9,348.4	7,415.5	– 3.0	–28.9	– 9.3	–11.7
Denmark (Copenhagen SE)	917.2	1,002.1	818.3	+ 0.4	–11.7	+ 1.1	– 7.6
France (SBF 250)	3,512.4	3,820.2	3,107.9	– 2.8	–20.0	– 6.9	–15.0
(CAC 40)	5,444.3	5,998.5	4,824.8	– 3.3	–21.4	– 8.1	–16.1
Germany (Xetra DAX)	6,041.2	6,795.1	5,388.0	– 2.8	–25.1	– 6.1	–14.3
Italy (BCI)	1,719.7	1,948.4	1,609.6	– 2.1	–21.2	–10.3	–18.1
Japan (Nikkei 225)	13,493.4	14,529.4	11,819.7	– 4.1	–65.3	– 2.1	– 7.1
(Topix)	1,329.7	1,441.0	1,162.0	– 3.3	–53.9	+ 3.6	– 1.7
Netherlands (AEX)	582.7	642.3	518.3	– 2.5	–16.9	– 8.6	–16.6
Spain (Madrid SE)	907.4	963.9	818.6	– 1.8	–20.8	+ 3.0	– 5.9
Sweden (Affarsvarlden Gen)	250.8	292.7	217.2	– 3.2	–37.3	– 9.6	–19.5
Switzerland (Swiss Market)	7,559.0	8,135.4	6,574.0	– 1.8	–10.1	– 7.1	–15.4
United States (DJIA)	10,872.6	11,337.9	9,389.5	– 2.1	– 7.3	+ 0.8	+ 0.8
(S&P 500)	1,248.1	1,373.7	1,103.3	– 3.2	–18.3	– 5.5	– 5.5
(Nasdaq Comp)	2,084.5	2,859.2	1,638.8	– 7.1	–58.7	–15.6	–15.6
Europe (FTSE Eurotop 300) *	1,445.2	1,545.5	1,279.0	– 2.2	–15.2	– 5.8	–14.0
Euro area (FTSE Ebloc 100) *	1,291.2	1,404.1	1,143.9	– 2.8	–16.7	– 7.3	–15.3
World (MSCI) †	1,120.6	1,249.2	1,014.6	– 2.9	–22.7	na	– 8.2
World bond market (Salomon) ‡	427.3	447.8	426.2	– 0.1	– 7.1	na	– 3.8

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in dollar terms.
‡Salomon Smith Barney World Government Bond Index, total return, in dollar terms.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Trade, exchange rates and budgets

May 31st 2001
From The Economist print edition

Trade, exchange rates and budgets

	Trade balance*, $bn latest 12 months		Current account $bn latest 12 mths		The Economist poll % of GDP, forecast 2001	2002	Exchange rate trade-weighted† May 30th	year ago	Currency units per $ May 30th	year ago	per £	per euro	per ¥100	Budget balance % of GDP 2001‡
Australia	− 2.6	Apr	− 15.1	Q4	− 2.9	− 3.2	72.2	75.0	1.95	1.75	2.77	1.67	1.62	0.1
Austria	− 4.6	Jan	− 4.2	Mar	− 2.5	− 2.0	99.6	100.0	16.1	14.8	22.9	13.8	13.3	-0.6
Belgium	+ 12.8	Mar	+ 11.6	Dec	+ 4.2	+ 4.3	98.0	98.7	47.1	43.5	67.0	40.3	39.1	0.7
Britain	− 44.3	Mar	− 24.5	Q4	− 2.1	− 2.0	107.9	105.8	0.70	0.67	–	0.60	0.58	1.2
Canada	+ 40.4	Mar	+ 12.7	Q4	+ 1.2	+ 1.0	78.2	79.3	1.54	1.50	2.20	1.32	1.28	2.6
Denmark	+ 5.9	Mar	+ 3.7	Mar	+ 1.4	+ 1.4	100.8	100.6	8.70	8.05	12.4	7.46	7.23	2.9
France	+ 0.9	Mar	+ 25.0	Feb	+ 1.6	+ 1.6	100.5	101.5	7.65	7.07	10.9	6.56	6.36	-0.5
Germany	+ 54.4	Mar	− 25.7	Mar	− 1.4	− 1.1	97.3	98.2	2.28	2.11	3.25	1.96	1.90	-1.7
Italy	+ 1.6	Mar	− 5.6	Feb	− 0.3	nil	71.8	72.4	2,259	2,088	3,215	1,936	1,878	-1.3
Japan	+ 98.9	Apr	+110.5	Mar	+ 2.2	+ 2.2	142.3	153.6	120	108	171	103	–	-6.3
Netherlands	+ 16.5	Mar	+ 13.7	Q4	+ 4.1	+ 4.0	96.8	97.6	2.57	2.38	3.66	2.20	2.14	1.3
Spain	− 39.1	Mar	− 17.3	Feb	− 2.9	− 2.6	73.5	74.0	194	179	276	166	161	nil
Sweden	+ 11.0	Mar	+ 5.5	Mar	+ 2.3	+ 2.2	76.0	83.8	10.59	9.01	15.1	9.08	8.81	3.6
Switzerland	− 0.4	Apr	+ 31.1	Q4	+11.8	+11.4	106.9	104.4	1.78	1.70	2.53	1.52	1.48	na
United States	−454.6	Mar	−434.9	Q4	− 4.3	− 4.0	119.9	111.3	–	–	1.42	0.86	0.83	2.1
Euro area	− 4.5	Mar	− 32.6	Mar	− 0.3	− 0.1	76.3	79.2	1.17	1.08	1.66	–	0.97	-0.6
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 13.3	Mar	+ 9.7	Mar	na	na	77.1	76.9	6.73	6.41	9.58	5.77	5.59	5.3
Greece	− 7.5	Q4	− 8.1	Dec	na	na	56.9	57.9	385	363	548	330	320	nil
Iceland	− 0.5	Mar	− 0.9	Q4	na	na	na	na	97.1	75.8	138	83.2	80.7	2.4
Ireland	+ 27.1	Feb	− 0.7	Q4	na	na	86.7	87.2	1.12	0.85	1.59	0.96	0.93	4.5
Luxembourg	− 2.4	Jan	+ 1.6	Q4	na	na	98.0	98.7	45.6	43.5	64.9	39.1	37.9	3.6
New Zealand	− 0.3	Apr	− 2.7	Q4	na	na	79.8	81.2	2.36	2.19	3.36	2.02	1.96	1.0
Norway	+ 27.5	Apr	+ 23.0	Feb	na	na	95.4	90.5	9.11	8.96	13.0	7.81	7.57	15.3
Portugal	− 12.4	Feb	− 10.2	Feb	na	na	88.6	89.1	227	216	323	194	188	-1.2

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †1990=100, Bank of England. ‡OECD estimate.

Text refers only to the first 16 countries listed

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Money and interest rates

May 31st 2001
From The Economist print edition

Money and interest rates

	Money supply* % change on year ago			Interest rates % p.a. (May 30th 2001)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+14.1	+ 7.5	Mar	4.97	6.27	4.86	6.08	6.27	7.37
Britain	+ 7.7	+ 7.9	Apr	5.19	6.19	5.08	5.17	5.17	6.75
Canada	+11.4	+ 4.8	Apr	4.36	5.76	4.97	5.98	6.01	7.38
Denmark	– 2.2	– 6.5	Mar	4.84	4.58	4.85	5.36	5.64	7.24
Japan	+ 6.0	+ 2.7	Apr	0.01	0.03	0.01	1.26	1.64	0.56
Sweden	+ 5.8	– 0.3	Apr	4.02	3.95	4.50	5.30	5.11	5.40
Switzerland	– 2.2	+ 2.4	Apr	3.20	3.16	3.31	3.43	4.10	4.31
United States	– 0.1	+10.4	Apr	3.75	6.62	4.29	5.51	6.28	7.33
Euro area†	+ 1.8	+ 5.2	Apr	4.55	4.65	4.31	5.06	5.13	5.69

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 5.84%, Japan No.231 1.28%. Central bank rates: US fed funds 4.00%, ECB refinancing 4.50%, BOJ overnight call 0.01%, BOE repo 5.25%.
Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, OM Fixed Income Exchange, Warburg Dillon Read, WEFA Group, Westpac, Thomson Financial Datastream. Rates cannot be construed as banks' offers.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Overview

May 31st 2001
From The Economist print edition

The collapse in global demand for information-technology equipment is hurting East Asia. In the year to the first quarter, **Taiwan's** GDP growth fell to a 25-year low of 1.1%, from 4.1% in the fourth quarter of last year. Over the same period, Hong Kong's GDP growth slowed to 2.5%, from 6.9% in the fourth quarter. In the year to April, Singapore's industrial production fell by 0.8%, but South Korea's output rose by 5.7%. Hong Kong's trade deficit widened to $11.9 billion in the year to April.

The **Istanbul** stockmarket tumbled by 11.3%, because of political bickering over Turkey's latest IMF-backed reform package, and a fall in the lira.

Jakarta rose by 7.4% on hopes that President Abdurrahman Wahid would at last be pushed from office.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Financial markets

May 31st 2001
From The Economist print edition

Financial markets

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	May 30th		Dec 31st 2000	
	May 30th	year ago	May 30th	% p.a.		one week	in local currency	in $ terms
China	8.28	8.28	11.8	na	2,298.1	+0.5	+4.8	+4.8
Hong Kong	7.80	7.79	11.1	3.88	13,420.1	-3.0	-11.1	-11.1
India	47.0	44.6	66.8	7.75	3,662.0	-0.3	-7.8	-8.3
Indonesia	11,395	8,610	16,215	16.47	408.9	+7.4	-1.8	-16.6
Malaysia	3.80	3.80	5.41	3.30	570.7	+1.8	-16.0	-16.0
Philippines	50.6	42.7	72.0	10.31	1,396.5	-3.4	-6.6	-7.7
Singapore	1.81	1.74	2.58	2.29	1,662.7	-1.4	-13.7	-17.4
South Korea	1,289	1,130	1,834	5.78	628.4	+0.9	+24.5	+22.2
Taiwan	34.0	30.8	48.3	4.15	5,057.1	-2.9	+6.6	+3.8
Thailand	45.4	39.2	64.6	2.63	310.2	-0.3	+15.2	+10.1
Argentina	1.00	1.00	1.42	10.07	427.9	-2.9	+2.6	+2.5
Brazil	2.36	1.83	3.36	16.80	14,489.4	-1.3	-7.1	-23.2
Chile	610	524	868	3.59*	5,420.1	+3.3	+11.3	+4.7
Colombia	2,326	2,099	3,310	12.69	876.5	+1.6	+23.0	+18.2
Mexico	9.16	9.51	13.0	10.76	6,586.9	-2.9	+16.5	+22.3
Peru	3.62	3.51	5.1	11.60	1,313.3	-0.4	+8.7	+6.0
Venezuela	715	681	1,017	14.00	7,849.1	nil	+15.5	+13.1
Egypt	3.86	3.45	5.49	9.08	6,621.1	+0.8	-13.6	-12.9
Israel	4.13	4.17	5.87	5.20	417.0	-2.2	-15.7	-17.4
South Africa	7.96	6.96	11.3	10.60	9,363.1	-1.1	+12.5	+6.9
Turkey	1,161,000	616,070	1,652,103	59.00	10,687.1	-11.3	+13.2	-34.6
Czech Republic	39.9	38.9	56.7	5.05	432.9	+1.0	-9.5	-14.6
Hungary	296	279	421	11.15	7,006.7	+0.8	-10.7	-14.9
Poland	4.0	4.4	5.7	16.99	15,493.4	-1.1	-13.2	-10.3
Russia	29.1	28.2	41.5	25.00	205.6†	-1.1	+45.9	+43.5
EMF (MSCI)‡	1.00	1.00	1.42	na	331.2	-2.1	na	-0.8
EMBI+§	1.00	1.00	1.42	na	209.3	-1.3	na	+3.7

*Inflation adjusted. †In dollar terms. ‡Emerging Markets Free. §J.P. Morgan Chase's Emerging Markets Bond Index Plus.

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Economy

May 31st 2001
From The Economist print edition

Economy

	% change on year earlier						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 8.1	Q1	+11.5	Apr	+ 1.6	Apr	+22.3	Apr	+20.5	2000	178.0	Feb
Hong Kong	+ 2.5	Q1	– 0.2	Q4	– 1.4	Apr	–11.9	Apr	+ 8.8	Q4	115.1	Apr
India	+ 6.0	Q2	+ 1.3	Mar	+ 2.5	Mar	– 6.3	Mar	– 5.4	Q4	39.9	Apr
Indonesia	+ 4.0	Q1	+ 4.5	Q4‡	+10.5	Apr	+26.9	Mar	+ 5.5	Q3	22.3	Feb
Malaysia	+ 3.2	Q1	+ 0.5	Mar	+ 1.6	Apr	+15.3	Mar	+ 8.4	Q4	26.8	Mar
Philippines	+ 3.6	Q4	– 2.0	Mar	+ 6.7	Apr	+ 7.3	Mar	+ 9.4	Jan	12.2	Feb
Singapore	+ 4.5	Q1	– 0.8	Apr	+ 2.0	Apr	+ 4.2	Apr	+21.8	Q1	80.2	Feb
South Korea	+ 3.7	Q1	+ 5.7	Apr	+ 5.3	Apr	+14.3	Apr	+14.0	Apr	93.5	Apr
Taiwan	+ 1.1	Q1	– 5.9	Apr	+ 0.4	Apr	+10.6	Apr	+12.0	Q1	110.6	Mar
Thailand	+ 3.1	Q4	– 1.8	Mar	+ 2.6	Apr	+ 3.7	Mar	+ 7.3	Mar	31.7	Mar
Argentina	– 2.0	Q4	+ 8.6	Apr	– 0.2	Apr	+ 1.5	Mar	– 9.4	Q4	21.9	Mar
Brazil	+ 3.8	Q1	+ 7.7	Mar	+ 7.1	Apr	– 1.4	Apr	–26.6	Apr	35.1	Feb
Chile	+ 3.3	Q1	+ 3.1	Apr	+ 3.5	Apr	+ 1.5	Apr	– 1.4	Q1	14.5	Mar
Colombia	+ 1.8	Q1	+ 3.0	Mar	+ 8.0	Apr	+ 1.3	Feb	– 0.1	Q4	9.7	Apr
Mexico	+ 1.9	Q1	– 1.9	Mar	+ 7.1	Apr	– 9.5	Apr	–17.7	Q4	40.2	Mar
Peru	– 3.6	Mar	– 6.3	Mar	+ 2.7	Apr	– 0.4	Mar	– 1.7	Q4	8.2	Feb
Venezuela	+ 3.5	Q1	na		+12.1	Apr	+17.5	Nov	+12.5	Q1	12.0	Mar
Egypt	+ 6.5	2000†	+ 9.4	2000†	+ 2.4	Mar	–10.4	Q4	– 0.8	Q4	12.9	Jan
Israel	+ 3.0	Q4	– 1.0	Mar	+ 1.2	Apr	– 7.5	Apr	– 0.7	Q3	23.5	Apr
South Africa	+ 2.7	Q1	+ 1.8	Mar	+ 6.5	Apr	+ 3.6	Mar	– 0.5	Q4	6.2	Mar
Turkey	+ 8.3	Q4	– 7.6	Mar	+48.3	Apr	–27.0	Feb	– 9.4	Feb	18.5	Apr
Czech Republic	+ 3.9	Q4	+ 9.8	Mar	+ 4.6	Apr	– 3.5	Mar	– 2.3	Q4	13.0	Apr
Hungary	+ 4.2	Q4	+ 5.3	Mar	+10.3	Apr	– 2.4	Mar	– 1.7	Mar	11.3	Apr
Poland	+ 2.4	Q4	+ 3.6	Apr	+ 6.6	Apr	–10.3	Mar	– 9.0	Mar	27.1	Mar
Russia	+ 6.8	Q4	+ 5.2	Apr	+25.0	Apr	+60.7	Mar	+45.9	Q1	25.9	Mar
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Pakistan	+ 3.9	1999†	+ 7.9	Oct	+ 4.2	Mar	– 1.7	Apr	– 2.5	1999	1.1	Jan
Saudi Arabia	– 0.8	1999	na		– 0.8	Feb	+24.9	1999	+ 0.4	1999	16.9	Mar

*Excluding gold, except Singapore; IMF definition. †Year ending June. ‡New series.

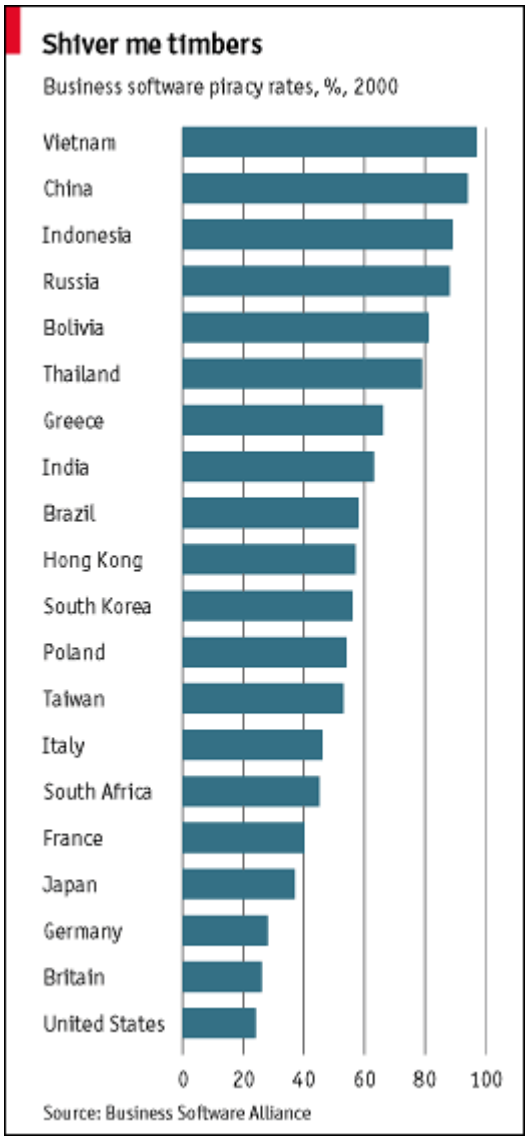
Text refers only to the first 25 countries listed

Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.

Shiver me timbers

May 31st 2001
From The Economist print edition

Over a third of all business software is pirated, according to the Business Software Alliance. The group estimates that piracy cost software makers almost $12 billion last year. The global piracy rate rose from 36% in 1999 to 37% in 2000, largely because of fast growth in computer usage in countries with high piracy rates, such as China and Japan.



Copyright © 2007 The Economist Newspaper and The Economist Group. All rights reserved.